UNITED STATES
BARRIERS TO TRADE AND INVESTMENT

REPORT FOR 2005

EUROPEAN COMMISSION

Issued: March 2006

CONTACT INFORMATION

This report has been published by:

European Commission
Directorate General for Trade
200 Rue de la Loi
1049 Brussels, Belgium
Tel : +32-2-295-2856, Fax : +32-2-296-7393
Email : TRADE-E3@cec.eu.int
Contacts : Mr. Matthew Baldwin and Mr. George Cunningham

where any further enquiries or comments concerning this report can be sent.

For market access information, economic and regulatory information, applied tariff levels and analyses of trade issues, please consult the European Commission's Market Access Database website:

http://mkaccdb.eu.int

Additional information and updates on EU-US trade relations, as well as the electronic version of the Trade Barriers Report can be found in the "Bilateral Trade Relations" Section of the website of the European Commission's Directorate General for Trade:

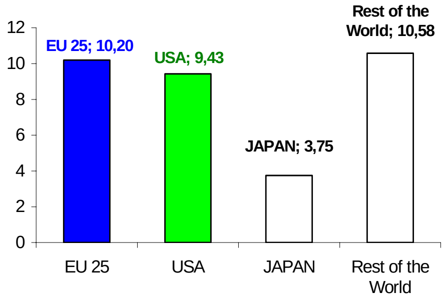
http://europa.eu.int/comm/trade

This report has been compiled by the European Commission's Directorate General for Trade in co-operation with the European Commission's Delegation in Washington, D.C. and other services of the Commission on the basis of material available to them at 31st December 2005.

TABLE OF CONTENTS

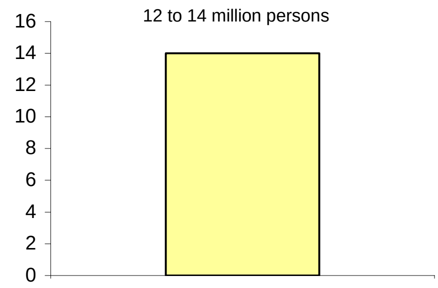
EU-US Economic Interdependence

Gross Domestic Product
2004
trillions euro



Source: Eurostat (Newcronos), DG ECFIN (Ameco)

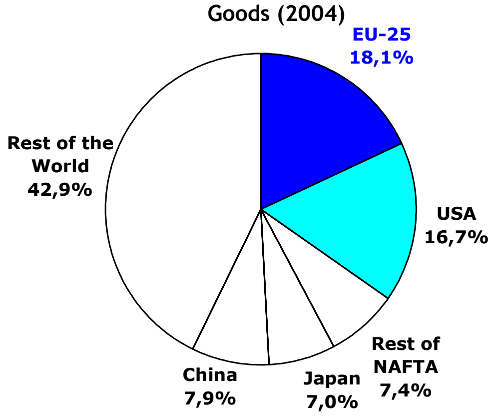
Estimated workers employed in each other's economies



Source: Hamilton and Quinlan, "Deep Integration- How Transatlantic Markets are leading Globalisation".

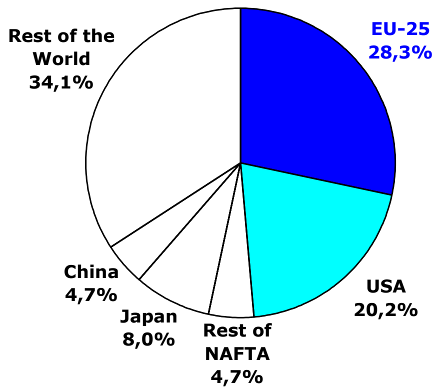
Share of World trade
(imports + exports)

Goods (2004)



Source: IMF (Dots), Eurostat

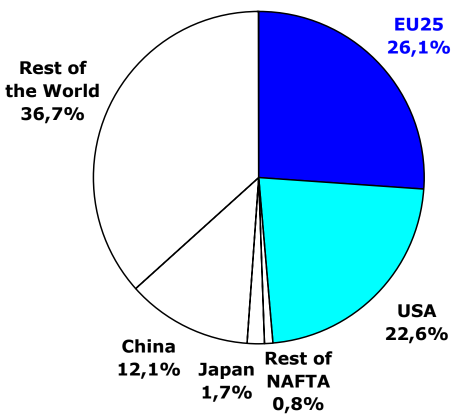
Services (2004)



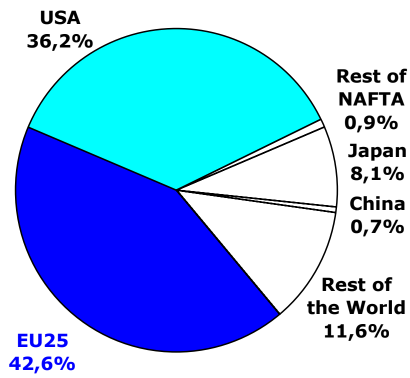
Source: WTO, Eurostat

Share in World FDI Flows (2000-2004)

Inflows



Outflows



Source: UNCTAD, Eurostat
World is calculated excluding intra-EU Trade.

EXECUTIVE SUMMARY

Transatlantic Economic Initiative

The publication of this report comes at a time of continued improvement in relations between the European Union and the United States. In the economic field, this is exemplified by the decision of both sides at the 2005 EU-US summit to launch the Transatlantic Economic Initiative. This aims to generate further wealth and employment on both sides of the Atlantic by finding ways to improve how the two economies work together.

The EU and the US are each other's main trading partners, accounting for the largest bilateral trade relationship in the world. Both are also key players in the Doha Development Agenda (DDA). The economic relationship is therefore a very significant one. Nevertheless, a considerable number of impediments in the transatlantic trade and investment relationship still need tackling. Even if the economic impact of these trade disputes constitutes only a small proportion of the overall EU-US trade volume, they need to be managed adequately. The European Commission remains firmly committed to addressing existing and future obstacles to trade and investment in the US market in a constructive way,

The primacy of the multilateral rules-based system

The US Administration continues to stress that its trade policy remains firmly rooted in the values of openness, transparency and respect for the rule of law. These are of course principles to which the EU also subscribes. We both, for instance, continue to regard the WTO as a fundamental element in moving steadily towards open world markets and attach prime importance to the Doha Round of trade negotiations.

But problems remain. Domestic pressure is strong – perhaps growing – on both sides of the Atlantic. What remains of concern is that pressure on the US to adopt protectionist or other unfair trade measures is apparently greater than willingness to find agreed solutions. The continued poor record of compliance with WTO dispute settlement findings illustrates this problem.

This report sets out the remaining principal US barriers to trade and investment in 2005, notable in the areas listed below. We hope very much that work in the Transatlantic Economic Initiative will eliminate or reduce many of these problems.

Extraterritoriality

The extraterritorial provisions of certain US legislation that hamper international trade and investment by seeking to regulate EU trade with third countries conducted by companies outside the US pose problems for the EU. Although these issues have been relatively quiet in recent years, a number of provisions remain on the US statute book, especially the *Helms-Burton Act* and the *Iran Libya Sanctions Act* (although the application of ILSA with respect to Libya was terminated by President Bush in April 2004). Progress towards a lasting solution to this dispute was made at the 18 May 1998 EU-US Summit. Implementation of the Understanding reached at that occasion, however, continues to depend on legislative action by the US Congress, which is still awaited.

Unilateralism

Whilst the US has in practice made extensive use of WTO fora, including its dispute settlement system, it has not renounced the possibility of taking unilateral trade measures. As a result, the EU has won two WTO dispute settlement cases, one against the US suspension of customs liquidation in the banana dispute, and one against *Sections 301 to 310 of the US 1974 Trade Act*. The EU also initiated dispute settlement proceedings against the *"carousel" legislation* (Section 407 of the Trade and Development Act of 2000), which, however, has so far not been applied.

Tariff barriers

Tariffs have been substantially reduced in successive rounds of negotiations in the WTO (formerly the GATT). Negotiations in the current Doha Development Round have not yet been concluded. The EU's concern is now focused on a relatively limited number of US "peaks" and other significant tariffs (e.g. food products and textiles) where less progress has been made. The EU hopes that there will be a substantial reduction of US tariffs as an outcome of the Round.

Other customs barriers

EU exports face a number of additional customs impediments, such as the customs user fees (Merchandise Processing Fee or Harbour Maintenance Tax) and excessive invoicing requirements on importers, which add to costs in a similar way to tariffs. There is also a lack of recognition of the EU as a customs union, a position reflected by the US Government's negative stance towards EU membership in the *World Customs Organisation* (WCO), for example. Serious questions are also posed by the limited extension of the *US Bureau of Customs and Border Protection's of the Department of Homeland Security* (CBP) C-TPAT scheme to foreign manufacturers in terms of its cost burdens and discriminatory effect on European exporters, an issue that needs addressing in the framework of the Transatlantic Economic Initiative. Finally, the implementation of the food-related provisions of the 2002 Bioterrorism Act puts severe burdens on the trade in food and feed products to the US.

Regulatory barriers and technical barriers to trade

Regulatory barriers have recently gained a lot of attention as significant impediments to trade and investment between the EU and the US. A more integrated and streamlined transatlantic regulatory environment would have a positive impact on the competitive potential of EU and US companies and economies.

Reinforced regulatory cooperation is therefore important to help dismantling existing regulatory barriers and preventing new ones from arising. Recent efforts include the development of the 2002 voluntary *EU-US Guidelines for Regulatory Co-operation and Transparency* and the 2004 and 2005 *Roadmaps for EU-US Regulatory Cooperation.* Moreover, *a high level Regulatory Cooperation Forum* to facilitate regulatory dialogues was established by the EU-US Economic Initiative at the June 2005 EU-US Summit.

While there have been important successes in EU-US regulatory co-operation, issues remain. EU exporters continue to face a number of post-import impediments. The proliferation of regulations at State level presents particular problems for companies without offices in the US. In addition, the non-use of relevant international standards as a basis for technical regulations in the US creates difficulties for EU exporters. Other related difficulties concern labelling requirements and excessive reliance on third-party certification. The *EU-US*

Agreement on Mutual Recognition, in force since 1 December 1998, has not been fully implemented. EU exports of electrical and electronic equipment, including telecommunications equipment, which amount to 6% of total EU exports to the US, are particularly affected by the obstacles described.

The EU considers the current US visa non-reciprocity regime as a serious barrier to trade and investment which can in some cases cause harm to the competitiveness of EU companies.

Sanitary and Phytosanitary Measures

In the agricultural area, a number of sanitary and phytosanitary issues remain a significant source of difficulty for the EU. Most notable amongst these are the problems encountered in trading animal products. For example, US measures result in the prohibition of imports from the EU of beef and other uncooked products. It was hoped that most of these problems might be solved by the *Veterinary Equivalence Agreement*, signed on 20 July 1999. However no real progress has materialised so far, not least because of the lack of implementation of the agreement as foreseen by the US.

Government procurement

Despite the fact that the WTO Government Procurement Agreement increased substantially the tendering opportunities for the two sides, the EU remains concerned about the wide variety of discriminatory *Buy America* provisions that persist, to which are being added others for federally funded infrastructure programmes. Small business set-aside schemes also limit bidding opportunities for EU contractors. The EU also faces extraterritorial sub-federal selective purchasing legislation, restricting the ability of EU and other companies doing business with specific countries if at the same time they wish to bid for contracts in various US States and cities.

National security restrictions

The lack of a clear definition of “national security” seems to have led to an overly wide interpretation of the term by the US. The EU recognises the need for a high level of security around the movements of trade and investment, but has long expressed concern about its excessive use which could be interpreted to be a disguised form of protectionism. This can be seen in relation to import, procurement and investment restrictions, as well as the extraterritorial application of export restrictions. In particular, the 1988 *Exon-Florio Amendment* and subsequent legislation to restrain foreign investment in, or ownership of, businesses relating even tangentially to national security have proved to be problematic. Further amendments to expand the scope of the Exon-Florio Amendment would be contrary to US interests at home and abroad.

The events of 11 September 2001 have seen the US build on existing measures of this kind. For example, in the telecoms sector, US law enforcement agencies have imposed strict corporate governance requirements on companies seeking *Federal Communications Commission* (FCC) approval of the foreign takeover of a US communications firm in the form of far-reaching Network Security Arrangements.

The EU has some serious concerns about a number of these proposals, in particular those relating to bio terrorist threats, and unilateral measures related to security in air and maritime transport. This is because - in some areas - these measures appear to be far more trade restrictive than necessary.

It is hoped that the Transatlantic Economic Initiative will be able to address some of these concerns.

Trade defence instruments

US trade defence instruments are increasingly considered a major trade barrier. Often the methodology used by US authorities and the apparently protectionist application of US trade defence instruments have been challenged successfully- and not only by the EU - in the WTO Dispute Settlement system. Several aspects of US trade defence legislation and practices, including those relating to safeguards, have been shown to be inconsistent with WTO Agreements. WTO rulings against US trade remedies include the so-called "Byrd Amendment" (the WTO-incompatible distribution of the collected anti-dumping and countervailing duties to the US complainants), and the US methodology used in privatisation cases (the US WTO-incompatible practice of countervailing pre-privatisation subsidies without showing whether the privatised company has obtained a benefit which goes against the Agreement on Subsidies and Counter Measures).

Subsidies and Government Support

The EU continues to be concerned about the significant direct and indirect government support given to US industry, by means of direct subsidies, protective legislation and tax policies.

The *Foreign Sales Corporations* (FSC) scheme has been a matter of major concern for many years. The US has not fully implemented the Appellate Body's report of January 2002, which confirmed that the FSC replacement, the *FSC Repeal and Extraterritorial Income Exclusion Act* (ETI), was still an export subsidy inconsistent with the WTO rules. Legislation (the *American Jobs Creation Act of 2004* – "the repeal Act") repealing the FSC-ETI legislation was signed into law by President Bush on 22 October 2004. The repeal of FSC-ETI represents a major step towards solving a long standing dispute. The repeal Act, however, includes transitional and grandfathering provisions which are WTO incompatible. In particular, the repeal Act provides that FSC/ETI benefits will still be available to US exporters up to the end of 2006 (at the level of 80% and 60% for 2005 and 2006 respectively) and in some cases for an unlimited period thereafter. A WTO dispute settlement procedure on those provisions of the repeal Act was, therefore, initiated. The final report of the WTO panel was released on 30 September 2005 and circulated to WTO members. The report concludes that despite some major changes to its legislation the US has yet to fully abide by previous WTO rulings and the recommendations of the WTO Dispute Settlement Body.

The adoption by the US Congress of the *2002 Farm Act* increases significantly the trade-distorting effect of US farm subsidies. This Act is clearly inconsistent with the express commitments of WTO Members, reinforced at Doha in November 2001, that farm policies should be reformed in the direction of less trade distorting forms of support. The EU's reforms of the Common Agricultural Policy agreed in 2003 and 2004 are clearly in line with this WTO commitment.

The EU also remains concerned about the significant level of support from all levels of the US government to US aircraft manufacturers, which is now the subject of Panel proceedings in the WTO, and to the US shipbuilding and steel industries.

Finally, concerning state aid for airlines, while recognising the severe financial consequences of the events of 11 September 2001 on US airlines and the need to ensure that vital transport services in the US are maintained, the EU considers that on-going large scale financial assistance provided by the US Government to US air carriers represents a significant protection from the commercial pressures also facing foreign carriers, and is an impediment to fair trade on transatlantic air routes. Meanwhile, the EU has adopted a regulation (Reg. No 868/2004) that allows for specific measures to be taken against third countries' carriers in order to counteract subsidisation and unfair pricing practices resulting from non-commercial advantages.

Limits on foreign investment

Aside from the limitations on national security grounds imposed by the Exon-Florio Amendment (mentioned above), a number of additional restrictions on foreign investment remain, notably in the shipping, energy and communications sectors. In addition, various US laws provide for conditional national treatment, notably in relation to subsidies in the area of science and technology research. The recent agreement on aviation services is a positive step in reducing barriers in this sector.

Tax measures

Concerns about federal tax measures focus on the nature of reporting requirements and the specific manner for calculating what is due. The EU deems US State-level "world-wide" unitary taxes as inconsistent with US obligations under its tax treaties with third countries.

Intellectual property

Despite a number of positive changes in US legislation following the Uruguay Round, issues such as those related to the recognition of "moral rights" of authors or government use of patents have not been resolved. The continued misuse of EU geographical indications on foods and drinks produced in the US, particularly in the wine sector, is the source of considerable frustration for EU producers. There is no protection of geographical indications in the US as such. Labelling regulations or collective trademarks systems are insufficient to give full protection. In addition, the US has lost dispute settlement cases related to US intellectual property legislation: *Section 110(5) of the US Copyright Act* (concerning licensing of music works) and *Section 211 of the Omnibus Appropriations Act* (on protection of trademarks).

Moreover, the co-existence of fundamentally different patent systems (the US continuing with its "first-to-invent" system whilst the "first-to-file" system is followed by the rest of the world) continues to create considerable interface problems for EU companies, not to speak of the financial effects of high litigation costs in patent matters. However, there has been some movement in Congress to reform the patent system by moving toward a "first-to-file" system and this can only be further encouraged.

Under the Transatlantic Economic Initiative, the EU and the US have agreed to exchange views on how to arrive at an effective and efficient international substantive patent law system.

Services

Professional services

The implementation of the *General Agreement on Trade and Services* (GATS) schedules for professional services has resulted in some improvement in market access. However, a number of problems, especially owing to regulation at the state level, remain to be tackled in order to secure more transparent and open access to the US market.

Communication services

The GATS Basic Telecommunications Agreement in force since February 1998 has led to significant commitments on market access. Nonetheless, the EU remains concerned about the considerable barriers that EU and foreign-owned firms wishing to get access to the US market still face (e.g. investment restrictions, lengthy proceedings, conditionality of market access, and reciprocity-based procedures). EU-based satellite communications operators in particular have experienced difficulties accessing the US market. The Federal Communications Commission (FCC), recognising the necessity to reform its procedures, issued new licensing procedures in May 2003 to accelerate the process and introduce more predictability. Additionally, the FCC is keen to promote the deployment of advanced broadband services but has been struggling in an extremely litigious environment to introduce a number of changes in rules governing dominant operators or operators that control essential facilities. Despite recent Supreme Court rulings which have enabled the FCC to begin addressing the regulatory framework for broadband and IP-enabled services, the existing uncertainty as to whether Congress will re-write the Telecommunications Act of 1996, and the growing trend towards concentration require further assessment of the impact of these developments on market access.

Financial services

EU reinsurers are obliged to lodge trust funds in the US, effectively requiring them to fully collateralise their exposures. The sums involved are of a significant size, and thus constitute a significant impediment to trade in such services between the EU and the US. In calculating the level of these trust funds, no credit is given for any retrocession that takes place in the US, nor is any account taken of the supervision that takes place in the home jurisdiction of the EU reinsurer.

Air transport services

Foreign ownership restrictions and restrictions related to US public procurement need to be dealt with. Post-11 September 2001 measures adopted on aviation security, as well as the large scale governmental financial assistance provided to US air carriers (see “subsidies and government support” above) are issues that need addressing.

Maritime transport services

Foreign-built vessels are prohibited from engaging in (direct or indirect) coastal trade (*Jones Act*), and cannot be documented and registered for dredging, towing or salvaging. In addition, there has been no progress on the elimination of requirements that US Government-owned or financed cargoes be shipped on US-flagged ships. Finally, US maritime security legislation is of EU concern, since it could result in discrimination between ports of WTO Member over a significant, even if limited, period of time. In addition, the US has not included any maritime services related commitments within even its most recent DDA services offer of May 2005.

Compliance with WTO rulings and recommendations

The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system, as expressed by Article 3 of the *Dispute Settlement Understanding* (DSU). The US needs to see how it can improve its record of compliance based on the recommendations and rulings formulated by the *WTO Dispute Settlement Body* (DSB) on the basis of Panel and Appellate Body findings

1 INTRODUCTION

The purpose of this report is to identify the key trade and investment barriers in the United States that need to be addressed to increase the flow of goods, services and investment across the Atlantic. Such barriers are not just damaging to EU companies, but also have a substantial negative impact on the US economy and consumers. The Transatlantic Economic Initiative shows that the will clearly exists to make further progress in developing trade and investment links across the Atlantic. There is a need to draw some long-standing disputes to an end, to solve others without always having to resort to litigation and thereby tackling barriers that impede economic growth for everyone's benefit.

2 EU-US TRADE RELATIONS

The publication of the United States Barriers to Trade and Investment Report for 2005 comes at a time of continued improvement in relations between the European Union and the United States. In the economic field, this has been exemplified by the decision of both sides at the 2005 EU-US summit to launch the Transatlantic Economic Initiative. This aims to generate further wealth and employment on both sides of the Atlantic by finding ways to improve how the two economies work together[2]. It gives further substance to the EU's and US's joint commitment in the *New Transatlantic Agenda* (NTA) and in the *Transatlantic Economic Partnership* (TEP) to strengthen and consolidate the multilateral trading system and to progressively reduce or eliminate barriers that hinder the flow of goods, services and capital between the two sides.

The transatlantic economic relationship has grown strongly, particularly over recent years to the significant benefit of both economies:

- The EU and the US are each other's main trading partners (taking goods and services together), accounting for the largest bilateral trade relationship in the world.
- In the year 2003, the total level of cumulative EU-US two-way investment amounted to around €1.5 trillion, composed of €731 billion of EU Foreign Direct Investment (FDI) in the US and around €772 billion of US-FDI in Europe.
- Including direct employment due to investment, indirect employment like joint ventures and other deals, and jobs supported by trade together, the overall "transatlantic workforce" is estimated at 12 to 14 million. Some 7 million workers in the US owe their jobs directly or indirectly to EU companies.
- In 2003, the total outflows of Foreign Direct Investments from the EU to the US were €53.7 billion, while €50.4 billion of US FDI flowed into the EU.
- In the year 2005, exports of EU goods to the US amounted to €250 billion, while imports from the US amounted to €234 billion.
- Concerning trade in services, EU exports to the US amounted in 2004 to €108.6 billion while EU imports from the US amounted to €93.0 billion.

Among other issues, the EU and US are currently cooperating as part of the Transatlantic Economic Initiative in the following areas:

- An IPR enforcement cooperation strategy for the 2006 EU-US Summit, establishing a working group to focus on specific activities, such as improved border enforcement cooperation, public-private partnership, and coordinated technical assistance to third countries.
- The implementation of the regulatory cooperation roadmap, including holding two meetings of the new high-level Regulatory Cooperation Forum in Spring 2006. Additionally, the US Barriers to Trade and Investment Report for 2005 will be used as a practical tool for regulators in their meetings to address regulatory barriers.

[2] Please see the joint EU-US Transatlantic Economic Initiative Work Programme at: http://europa.eu.int/comm/external_relations/us/economic_relations/joint_eu-us_work_prog.pdf

- The Financial Markets Regulatory Dialogue, in view of the global nature of financial markets and the potential gains from facilitating transatlantic capital flows;
- Working towards liberalisation of EU-US air services to bring significant consumer benefits, based on the agreement reached on 18th November 2005 and expected to come into force before the next summit, bringing significant consumer benefits.
- the visa waiver roadmap process for EU member countries not now participating in the US visa waiver programme and measures to facilitate business and tourist travel, including progress on the "trusted persons" initiative; and
- work on improving coordination of innovation policy and progress on several important programmes involving science, technology and research and development.

Both the EU and US are prioritising this work and continue to push for progress across the full range of issues in preparation for the next EU-US summit, to take place in the summer of 2006.

The multilateral context of the EU-US bilateral trade relationship is also worth highlighting. Both the EU and the US are key players in the Doha Development Agenda (DDA). This aims at deepening "rules-based" trade liberalisation and ensuring the integration of developing countries into the multilateral trading system. The EU and the US worked closely together with other WTO partners to bring about the July 2004 Framework Agreement. Envisaged reductions of tariff and non-tariff barriers would also unquestionably benefit the EU-US bilateral trade relationship.

The limited progress made at the 2005 Hong Kong WTO Ministerial means that while the show remains on the road, further major efforts will be needed, including from the EU and the US, to bring about an early and successful conclusion to these negotiations.

Despite these efforts, a considerable number of impediments in the transatlantic trade and investment relationship still need tackling. They range from traditional tariff and non-tariff barriers to differences in both sides' respective legal and regulatory systems. The conclusion of negotiations in 2005 for an EU-US air services agreement is very welcome. Ongoing work to repeal the Byrd Amendment is also encouraging. Nevertheless, US failure to comply with a number of World Trade Organisation (WTO) dispute settlement findings is still a major EU concern. Good progress was made in 2005 in trying to resolve the FSC/ETI export-contingent tax scheme but the remaining issues related to grandfathering have to be overcome. Most notably, the Airbus/Boeing dispute needs to be resolved in an amicable way as soon as possible.

Even if the economic impact of these trade disputes constitutes only a small proportion of the overall EU-US trade volume, they need to be managed adequately. The European Commission remains firmly committed to addressing existing and future obstacles to trade and investment in the US market in a constructive way, through agreed channels (bilateral, plurilateral and multilateral). But, ultimately, both our compliance with WTO rules is of importance not only from a bilateral point of view, but also for the credibility of the multilateral trading system.

3 EXTRATERRITORIALITY AND UNILATERALISM

3.1 Extraterritoriality

The application of US legislation outside the US territory is a long-standing feature of the US legal system manifesting itself in fields such as environment, banking and export control. While the EU may share some of the objectives underlying such laws, it is opposed, as a matter of law and principle, to the extraterritorial application of such domestic legislation insofar as it purports to force persons present in – and companies incorporated in - the EU to follow US laws or policies outside the US and merely to protect US trade or political interests. In particular, the EU opposes the extraterritorial provisions of certain US legislation that hampers international trade and investment by seeking to regulate EU trade with and investment in third countries. The EU has forcefully expressed, through a number of representations and *démarches*, its opposition to this kind of legislation-- or any secondary boycott and sanction legislation having extraterritorial effects.

Furthermore, on 22 November 1996, the EU adopted Council Regulation 2271/96 (the so-called "Blocking Statute") with a view to protect the EU and its economic operators, against the effects of extra-territorial legislation of this sort adopted by third countries. Other trading partners of the US, such as Canada and Mexico, have strengthened or adopted similar blocking legislation.

Helms-Burton Act

On 12 March 1996, President Clinton signed into law *the Cuban Liberty and Democratic Solidarity* (Libertad) Act of 1996 (referred to as the "Helms-Burton Act"). This was the latest in a series of legislative initiatives since the US proclaimed a trade embargo against Cuba in 1962 (Section 620 (a) of the Foreign Assistance Act of 1961; further reinforced by the Food Security Act of 1985 and the Cuban Democracy Act of 1992). The Helms-Burton Act *inter alia* (a) allows US citizens to file lawsuits for damages against foreign companies investing in confiscated US (including Cuban-American) property in Cuba (Title III of the Act) and (b) requires the US Administration to refuse entry to the US of the key executives and shareholders of such companies (Title IV of the Act). The EU is of the view that these measures are contrary to US obligations under the WTO Agreements, in particular the GATT and GATS. In that respect, the EC initiated a WTO dispute settlement procedure on 3 May 1996.

Iran and Libya Sanctions Act

On 5 August 1996, the *Iran and Libya Sanctions Act* (referred to as "ILSA") was signed into law. Despite strong opposition from the EU, ILSA was extended by another period of 5 years on 3 August 2001. The legislation provides for mandatory sanctions against foreign companies that make an investment above $20 million in any 12-month period contributing directly and significantly to the development of petroleum or natural gas resources in Iran. On 23 April 2004, the US terminated the application of ILSA with respect to Libya.

Understandings reached with the US

On 11 April 1997, an Understanding was reached with the US concerning the Helms-Burton Act and the ILSA, as well as the EU's WTO case regarding the former. The Understanding charted a path towards a longer-term solution through the negotiation of international disciplines and principles for greater protection of foreign investment, combined with the amendment of the Helms-Burton Act. As regards ILSA, the Understanding stipulated "the US will continue to work with the EU towards the objectives of meeting the terms" under the legislation which would permit the US President to waive the application of sanctions for EU Member States and EU companies. The EC agreed to suspend its WTO case, but reserved the right to restart or to re-launch the WTO dispute settlement procedure, if action was taken against EU companies or individuals under the Helms-Burton Act or ILSA, or waivers as described in the Understanding were not granted, or were withdrawn.

At the 18 May 1998 EU-US Summit in London, building upon the April 1997 Understanding, the EU and the US reached an Understanding on a package of measures to resolve the dispute regarding the Helms-Burton Act and ILSA. The Understanding offers the real prospect for a permanent solution, but still depends on acceptance by the US Congress before full implementation may take place. The Understanding contains three main elements.

The first element is the Understanding on investment disciplines. It contains a clear commitment on the part of the US Administration to seek from Congress the authority to grant a waiver from Title IV of the Helms-Burton Act (visa restrictions) without delay. With respect to Title III of the Helms-Burton Act (submission of lawsuits against "trafficking in expropriated property"), the Understanding provides for a US commitment to continue to waive the right of US citizens to file lawsuits. Contrary to the Understanding, neither the waiver under Title IV nor a permanent waiver under Title III was granted. However, the Understanding waivers under Title III have been continuously granted on a six-monthly basis (the last waiver having been granted on 15 July 2005 with effect as of 1 August 2005) and no action has been taken, so far, against EU citizens or companies under Title IV, although the US Administration continues to investigate certain EU companies' investments in Cuba. The existence of the Helms Burton Act and the lack of permanent waivers under Titles III and IV continue to constitute an on-going threat to EU companies doing or intending to do legitimate business in Cuba.

The second element is the Transatlantic Partnership on Political Co-operation (TPPC), which should be seen in conjunction with the EU's efforts vis-à-vis US Administration to restrain its use of unilateral sanctions with extraterritorial effects, so-called "secondary boycotts". The TPPC states that the US Administration will "not seek or propose, and will resist, the passage of" such sanctions legislation.

The last element of the Understanding relates to the ILSA. At the London Summit in 1998, the US Administration did not grant the EU a multilateral regime waiver as foreseen by the Understanding of 11 April 1997. However, the US determined, under Section 9(c) of ILSA, to waive the imposition of sanctions against a major EU investment project in gas exploration in the South Pars field in Iran and committed that similar cases could be expected to be granted similar waivers.

The Understanding reached at the May 1998 Summit in no way softens the EU's position that the Helms-Burton Act and ILSA are contrary to international law. The EU never acknowledged the legitimacy of these Acts and fully reserves its right to resume the WTO case against the Helms-Burton Act.

Full implementation depends on congressional support, which still appears not to be forthcoming. The EU and its Member States can only fulfil the European commitments once the presidential waiver authority has been fully exercised.

Iran Non-Proliferation Act

On 14 March 2000, the *Iran Non-Proliferation Act* (INPA) was signed into law. It provides for discretionary sanctions against foreign companies transferring to Iran goods, services and technology listed under the international export control regimes, as well as any other item prohibited for export to Iran under US export control regulations, as potentially contributing to the development of weapons of mass destruction.

INPA constitutes extraterritorial legislation. On the one hand, it allows the US Administration to apply its own sanctions to exports which are subject to EU Member State and EU export control regimes, whilst on the other hand, it unilaterally expands the scope of export controls on EU exports beyond those multilaterally agreed upon. Its adoption is incompatible with the US commitment under the TPPC to resist the passage of extraterritorial sanction legislation.

EU concerns were repeatedly expressed in the run-up to the adoption of this Act. Taking these into account, President Clinton issued a statement when signing the bill into law, undertaking to work with Congress in order to seek to rationalise the reporting requirements on transfers deemed legal under the applicable foreign laws and consistent with the multilateral export control regimes.

This led to the arrest of persons in 2005 within the EU on grounds of extraterritorial application of criminal charges levied by the US against EU exporters who were not involved in export of dual use items covered by international export control regime nor EC Regulation on export of dual use items and were not related to Weapons of Mass Destruction Programmes.

The INPA prohibits the US Administration to acquire space related technology and services from Russia. In the framework of the International Space Station (ISS) program, the US has to acquire Russian Soyuz from 2006 in order to fulfil its space transportation obligations in the ISS program, because the US Space Shuttle will not be available in the extent necessary for maintaining the ISS. Europe, as a partner in the ISS program, depends on the US complying with its obligations. A new amendment to the INPA authorises the Bush Administration to derogate from certain provisions that had become an obstacle to the acquisition of Russian space technology and services. This new legislation is still being considered by Congress but has passed the US Senate already.

Several other instances and variations of US extra-territoriality can be found in, *inter alia*, various environmentally driven embargoes (see Section 5.5 on import prohibitions), export control legislation (see Section 5.9 on export restrictions) as well as, at the sub-federal level, selective purchasing laws (see Section 5.7 on government procurement).

Section 319 of the Patriot Act

Section 319 of the Patriot Act, adopted in 2001, deals with the forfeiture of funds in United States interbank accounts by those accused of money laundering and:

a. requires US correspondent banks to maintain certain records concerning a foreign bank that has a US correspondent account[3];

b. provides authority for the Treasury Secretary and the Attorney General to subpoena the foreign bank's offshore records concerning the account; and

[3] "an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution."

c. authorises forfeiture of deposits in the foreign bank.

Both the subpoena authority and the forfeiture clause have extraterritorial impact. The European Commission and others have complained vigorously both at the time of the adoption of the Act and during the comment period on proposed Treasury implementing regulations. In response, US authorities said that they had no intention of using this seizure authority indiscriminately or in derogation of existing and efficient mechanisms, such as Mutual Legal Assistance Treaties, for the seizure of funds located outside of the US.

Despite this reassurance, there have been growing allegations from European banks and from individual Member States that there is still a lack of clarity about the circumstances under which the US would make use of Section 319 and when it would refrain from doing so, that the US is going beyond reassurances provided in 2002, and that there have been several cases in which US funds of European banks have been seized.

The European Commission is concerned about such allegations and their impact on the legal certainty and ability of European banks to conduct business in the US. It is working with US Treasury authorities to determine the truth of the matter, and if necessary, how to remedy the situation in such a way as gives European banks the requisite legal clarity to conduct their business.

3.2 Unilateralism

Unilateralism may take the form of either unilateral sanctions or unilateral retaliatory measures against “offending” countries, or companies. Both types of measures are based on an exclusive US assessment of the actions of a foreign country or its legislation and administrative practice, without reference to, and sometimes in defiance of, multilaterally agreed rules. This approach has in the past cast doubt on US support for a multilateral rules-based system of addressing trade problems.

Continued suspension of obligations in the EC – Hormones dispute

The decision by a WTO panel of August 1997 that EU measures against hormones in beef were not in compliance with WTO rules was submitted to the Appellate Body in September 1997. In 1998, the EU lost the WTO dispute brought by the US and Canada on hormone beef. The reason was that the EU legislation banning hormone beef was not based on a specific risk assessment in relation to the risks arising from exposure to meat from animals treated with hormonal growth promoters. The Appellate Body overruled the earlier Panel but recommended that the EU bring its measures into conformity with obligations under the *Agreement on Sanitary and Phytosanitary Measures* (SPS) (see also Section 4.1 on Applied Tariff Barriers).

In order to comply with the WTO ruling, the European Commission proposed to Council and Parliament an amendment to the EU legislation with the objective of aligning it with the WTO ruling. The EU has eliminated those deficiencies by basing the new EU Hormones Directive of 22 September 2003[4] on a full scientific risk assessment that was conducted over the years 1999-2002. The new Directive was published and entered into force on 14 October 2003.This amendment was adopted by the Council on 22 July 2003, and the new Directive 2003/74/EC, implementing the WTO ruling, entered into force on 14 October. On 27 October

4 Directive 2003/74/EC of the European Parliament and of the Council of 22 September 2003 amending Council Directive 96/22/EC concerning the prohibition on the use in stockfarming of certain substances having a hormonal or thyrostatic action and of beta-agonists.

2003, the EU notified to the WTO that it had implemented the WTO ruling of 1998 and that, as a consequence, the US' sanctions vis-à-vis the EU are no longer justified. At the Dispute Settlement Body meeting of 7 November 2003 the EU proceeded to notify the new Directive as compliance in this case. The US (and Canada) disagreed and kept their retaliatory measures. The US also refused to initiate a compliance dispute in the WTO, as it is foreseen for such situations in the WTO's Dispute Settlement Understanding.

Informal attempts to persuade the US to suspend its sanctions pending a WTO review under Article 21.5 DSU having failed, the EU, on 8 November 2004, requested consultations with the US (and Canada) regarding the continued application of the countermeasures. The EU's challenge is directed against the US' continued suspension of obligations and its continued imposition of import duties in excess of bound rates on imports from the EU despite the EU's removal of the inconsistent measures. The US disagreed and since then refuse to lift its sanctions.

The WTO Agreement does not allow sanctions to be applied simply on one country's unilateral determination of alleged non-compliance by another. So the EU had no other choice than to initiate a WTO dispute against US sanctions against EU exports. Since the consultations held in December 2004 failed to resolve the dispute, the WTO dispute settlement panel was established on 17 February 2005. The panel proceedings are currently ongoing, with the first ever oral hearings open to the public based on a joint request by the parties. The ruling of the panel is expected no earlier than September 2006, although the confidential interim report is presently scheduled to come out in late July 2006.

Sections 301-310 of the 1974 Trade Act

The "Section 301" family of legislation provides a striking example of unilateral trade legislation that has been used on numerous occasions against the EU. *Section 301 of the 1974 Trade Act*, as amended by the *Omnibus Trade and Competitiveness Act of 1988* (hereafter, 1988 Omnibus Act), authorises the US Government to take action to enforce US rights under any trade agreement and to combat those practices by foreign governments which the US Government deems to be discriminatory, unjustifiable or restrictive to US commerce.

In addition, *Title VII of the 1988 Omnibus Act* relating to the removal of government procurement barriers was renewed. Under this law, the US decided in 1993 to impose sanctions against the EU and certain Member States for failure to liberalise purchases of telecoms equipment (see Section 5.7 of the Report "Government Procurement").

Furthermore, the 1988 Omnibus Act introduced a "*Special 301*" procedure targeting intellectual property rights protection outside the US. Under Special 301, the US Trade Representative (USTR) has created a "priority watch list" to identify foreign countries that are deemed to deny adequate and effective protection of intellectual property rights (IPR). Countries placed on the "priority watch list" are the focus of increased bilateral attention and the USTR officially initiates investigation procedures that may eventually result in unilateral trade measures. The "watch list" is reserved for those countries that do not protect US intellectual property or that deny market access to IPR-related industries. In its 2005 Special 301 review, the US has lowered the EU from the "priority watch list" to the "watch list" following a ruling of the WTO on the EU's regulation on the protection of geographical indications. The EU also remains on the "watch list" for the lack of full implementation of the EU Biotechnology Directive by some Member States. Furthermore, Hungary, Italy, Latvia, Lithuania, Poland, and the Slovak Republic are still on the "watch list", as are the candidate countries Bulgaria and Romania for lack of enforcement of intellectual property rights.

The US has resorted to unilateral action even since the WTO Uruguay Round Agreement entered into force on 1 January 1995. For instance, in the *Bananas* case, the US sought to suspend trade concessions against the EU before the DSB could decide whether the EU was in conformity with WTO rules.

The EU challenged Section 301 legislation, as it may result in some cases in unilateral determinations and retaliatory action even before the WTO bodies can make their own judgement on a given situation.

A WTO Panel ruled on 8 November 1999 that the statutory language of Sections 301 to 310 of the 1974 Trade Act was as such inconsistent with the rules of the WTO DSU. However, because the US administration formally undertook to always refrain from taking action under Sections 301-310 in the absence of a previous WTO determination, the Panel concluded that no violation was taking place. The practical result of this ruling has been to make Sections 301-310 ineffective against WTO members.

Nevertheless, in cases where bilateral (as opposed to WTO) agreements are alleged to have been violated, Section 301 is still regularly used as a unilateral trade policy instrument. Under the various elements of Section 301 legislation, trading partners are given no choice but to negotiate on the basis of an agenda set by the US, on the basis of judgements, perceptions, timetables, and indeed, US legislation.

The "Carousel" Legislation

Section 407 of the Trade and Development Act of 2000 (so-called "Carousel" law), enacted on 18 May 2000, provides for a mandatory and unilateral revision of the list of products subject to suspension of GATT concessions 120 days after the application of the first suspension and then every 180 days thereafter, in order to affect imports from Members which have been determined by the US not to have implemented recommendations made pursuant to a WTO dispute settlement proceeding. The EU believes that such legislation is fundamentally at odds with the basic principles of the DSU and, therefore, requested WTO consultations, which were held on 5 July 2000. The EU will immediately request the establishment of a WTO panel against US legislation should sanctions be rotated in this way.

4 TARIFF BARRIERS

4.1 Applied Tariff Barriers

Tariff peaks

Despite the substantial tariff reduction and elimination agreed in the Uruguay Round, the US retains a number of significant duties and tariff peaks in various sectors including food products, textiles, footwear, leather goods, jewellery and costume jewellery, ceramics, glass, trucks and railway cars.

The Information Technology Agreement

With regard to information technology (IT) products, the *Information Technology Agreement* (ITA) providing for the complete elimination of tariffs by the year 2000 on a large number of products, was implemented as of July 1997. The main elements of the new US tariff structure eliminate tariffs on all semiconductors, computers, computer peripherals and computer parts, electronic calculators, telecommunication equipment, electronic components (capacitors, resistors, printed circuits), semiconductor testing and manufacturing equipment and certain consumer electronic items. Although tariffs on optical fibre cables were eliminated under the ITA, the US refused to do the same for optical fibres on which they maintain a rather substantial protection. Tubes for computer monitors are excluded also. Attempts to broaden the scope and coverage of products of the ITA in the form of the ITA II have so far failed.

Retaliatory measures in the context of the Beef Hormones dispute

Regarding the Beef Hormones Dispute brought by the US and Canada to the WTO, after the deadline of 13 May 1999 imposed by the Arbitrator for the EU to implement the recommendations and the request by the US to the WTO DSB to allow the suspension of tariff concessions to the EU, the WTO Arbitrator determined that the level of impairment suffered by the US was $116.8 million. The US suspended the application of tariff concessions and related obligations by imposing a 100% *ad valorem* rate of duty on a list of mainly agricultural products from 29 July 1999 onward (see also Section 3.2 on Unilateralism - Continued suspension of obligations in the EC-Hormones Dispute).

Ceramics and Glass

At the end of the Uruguay Round, customs duties on ceramics and glass products remain relatively higher in the US than in Europe. During the Uruguay Round the US rejected the EU's offer to abolish tariffs in this sector, even though Mexico, one of Europe's leading competitors in the US market, has been enjoying since 2003 a zero rate by virtue of the NAFTA. There are products of importance for EU trade which will continue to be confronted by high tariffs even when the Uruguay Round reductions have been fully implemented. These include hotel and restaurant ware, on which the duty rates currently are 26% if made of porcelain or china and 28.7% for others, and certain drinking glasses and other glassware on which the duty rates currently up to 38% respectively.

Forest-based industries

The European producers of multilayer parquet (or engineered/laminated wood flooring) are experiencing difficulties in exporting their products to the US. These difficulties have arisen over the decision by US CBP to no longer accept the classification of such products under heading 44.18.30 of the customs code as parquet panels, which is duty free. Instead, CBP considers such products as plywood, which falls under heading 44.12 with a duty rate of 8%.

CBP has also reclassified another type of parquet previously also exported duty-free to the US under code 44.18.30, into 44.18.90 with 3.2% duty.

Textiles and Leather

The average trade weighted reduction made by the US in the Uruguay Round was 12% for textiles and clothing (to be implemented over ten years) and 5.2% for footwear. This means that many significant tariffs and tariff peaks will remain on products of export interest to the EU even when the Uruguay Round reductions have been implemented fully. These include:

(a) certain woollen fabrics and articles of apparel for which duty rates in 2002 reached 27.6% plus a specific rate of 9.7 cents/Kg in certain fabrics and 32.5% for some apparel and

(b) several footwear products for which the current duty rates are 48%, or 37.50% plus a specific rate of 90 cents/pair.

Jewellery

The US jewellery sector is protected by an average tariff of 6% with the highest post Uruguay Round tariff being 13.5%. The corresponding EU rates stand between 2.5% and 3%. Furthermore, the US maintains very significant import duties on certain semi-finished products made of precious metals. The very high raw material cost in this sector means that even modest tariff barriers reduce significantly the access of EU jewellery to the US market.

Automotive

There is a customs duty of 25% on vehicles for the transport of goods with a weight greater than 5 tonnes but less than 20 tonnes.

4.2 Tariff Quotas

Agriculture

The import of certain agricultural products into the US takes place mainly under WTO bound tariff quotas. The EU is monitoring closely the management of part of such quotas, i.e. quotas for which designated licences are issued. As regards historical and non-historical licenses, the quotas/licenses are managed by the US only.

In late 2004, the US administration adopted the necessary legislation (the US HTS and the Dairy Tariff-Rate Import Quota Licensing rules) to permit the issuing of import licences for EU-25 cheese quotas from 1 January 2005.

However, the EU remains concerned about certain built-in rigidities in the import licensing system for dairy products. The division of quotas for certain cheeses into Tokyo Round quantities and Uruguay Round quantities fragments access and complicates license applications by traders. Although the US Department of Agriculture’s Economic Research

Service (April 2001) identified inefficiencies in this type of quota administration, it continues to apply it. The European Commission hopes that this system will be modified, possibly after the conclusion of the Doha round, to facilitate trade.

The EU is concerned at the continuing attempts to introduce legislation through Congress that would limit imports of casein and Milk Protein Concentrates to a level that would be substantially lower than current levels of imports. This protectionist action is being considered in spite of the fact that these products are produced in the US only in limited quantities and are not in direct competition with US dairy products. Should legislation currently under consideration in Congress come into force, it would amount to a breach of US commitments under the WTO and would trigger the withdrawal of equivalent concessions by those trading partners affected or alternatively would require equivalent compensation by the US.

5 NON-TARIFF BARRIERS

Traditionally, the focus of trade negotiations has been on reducing tariff barriers. As they have come down, attention has switched increasingly towards non-tariff barriers. This chapter concentrates on a plethora of these barriers ranging from regulatory inconsistencies across the Atlantic to complex issues such as sanitary and phytosanitary measures, state-level impediments and import prohibitions amongst others.

Reduction of existing regulatory barriers to trade and investment - and preventing new ones emerging - would bring positive impacts on the competitive potential of EU and US companies and economies.

5.1 Regulatory Divergences and Barriers

EU exporters to the US market face steep regulatory barriers.

In the US, products are increasingly being required to conform to multiple technical regulations regarding consumer protection (including health and safety) and environmental protection. Though in general, not *de jure* discriminatory, the complexity of US regulatory systems can represent an important structural impediment to market access. For example, it is not uncommon that equipment for use in the workplace is subject to US Department of Labour certification, a county authority's electrical equipment standards, specific regulations imposed by large municipalities, and other product safety requirements as determined by insurance companies.

This situation is aggravated by the lack of a clear distinction between essential safety regulations and optional requirements for quality, which is due in part to the role of some private organisations as providers of assessment and certification in both areas. Moreover, for products where public standards do not exist, product safety requirements can change overnight as the product liability insurance market makes a new assessment of what will be required for insurance purposes.

This section looks in detail at the type of regulatory problems faced and the ways we are addressing these problems.

Barriers to free movement and business contacts

The EU considers the current US visa non-reciprocity regime as a serious barrier to trade and investment which can in some cases cause harm to the competitiveness of EU companies.

Non-use of international standards

A particular problem in the US is the relatively low level of use, or even awareness, of standards set by international standardising bodies. All parties to the TBT are committed to the wider use of these standards; but although a significant number of US standards are claimed to be "technically equivalent" to international ones, and some are indeed widely used internationally, very few international standards are adopted directly and some US standards are in direct contradiction to them. The claim that proper US standards, e.g. in the pressure sector, are "international" standards just because they are *de facto* widely used outside the US, does not take into account that international participation in their development, consultation and agreement in the *International Standardisation Organisation* (ISO) committees are missing, which qualify them as international standards. The EU has attempted to clarify some of these issues in discussions in the TBT Committee in Geneva, and in particular, to establish the position of international standards bodies in the context of the TBT, but agreement with the US has been difficult to reach. Discussions in the WTO on conformity assessment issues are progressing but are at an early stage.

US standards for *Non-destructive testing* (NDT) serve as an illustrative example of the non-use by US authorities of international standards.

In the field of pressure equipment and indeed in an even wider area, non-destructive testing (NDT) is an important element in ensuring product safety. A main requirement is the certification of the personnel that are to perform the NDT.

While the ISO Standard ISO 9712 on this matter has been supported by the *American National Standards Institute* (ANSI), the standard is not recognised in the context of the *American Society of Mechanical Engineers* (ASME) code on pressure vessels. As the ASME code plays an important role outside the US, this fact is of very significant relevance not only with regard to European manufacturers producing for the US market but also European manufacturers active in other parts of the world, even for sale of ASME-compliant pressure vessels within Europe.

In practice this means that NDT personnel in Europe need to be double-certified: once for ISO 9712/EN 473 and once again for ASME-NDT. This is inefficient, as the technical requirements of the NDT certification itself are in essence rather similar. The only substantial difference is that whereas in the ISO/EN case the test is performed by a competent third party, ASME requires the test to be performed in an ASME-proprietary fashion.

Apart from asking ANSI to ensure that the ISO 9712 is properly implemented in the US Pressure vessels code, the European Federation of non-destructive testing (EFNDT) submitted to ASME in October 1999 a code case (i.e. detailed wording of the proposal) to amend the corresponding section of the ASME code.

Excessive reliance on mandatory certification

Against the background of an international trend towards deregulation or the minimising of third party intervention in the regulatory process, one problem experienced in the US is the reliance on third party conformity assessment procedures for many industrial products.

Electrical and Electronic Equipment

Trade in electrical and electronic equipment is a significant ingredient in EU-US commercial relations. This product category amounts to 6% of total EU exports to the US. European exporters of electrical and electronic equipment and appliances face steep barriers to market their products on the US market.

First, there is not a single US market for electrical and electronic products -- partially divergent federal, regional, state, sectoral and even county and city technical regulations, procurement specifications and product standards split up the market. It is not sufficient to comply with federal regulations and obtain clearance from CBP to market electrical and electronic equipment in the US. For example, Underwriter's Laboratories (UL) have complete discretion on standards on electrical safety and occasionally make seemingly arbitrary changes to them. In 1993 UL revised standard 1028 on hair clipping and shaving appliances, amending the specifications for the on/off switch. The new UL requirement adds nothing to the safety of these appliances, but adds considerable costs to European manufacturers. UL list the products that comply with the applicable standards, but do not approve them. This is done by a variety of competing testing and certification agencies, some offering testing facilities in the EU. The information on import conditions received by European equipment exporters from US embassies, chambers of commerce abroad and CBP often proves insufficient and inadequate. The *de facto* fragmentation of the US market forces exporters to make expensive adaptations of their product models and type approvals to local and sectoral requirements, undermining the economies of scale that sales on a unified marketplace of the size of the US market would otherwise make possible.

Second, besides diverging among themselves, the standards on electrical and electronic products used in the US diverge most often from international *International Electrotechnical Commission* (IEC) standards. These international standards are applied not only in Europe but in a great majority of third countries too. As a consequence European exporters cannot export to the US the electrical and electronic models that they sell to the rest of the world. For instance, the revised UL standard on hair clipping and shaving appliances mentioned in the previous paragraph required the subsequent modification of the related International Electrotechnical Commission (IEC) standards. Moreover, the US actively seeks to deflect countries with which it has particularly intense trade in electrical and electronic equipment from the path of international standardisation. In 2001, this campaign to undermine the use of international standards in third countries has increased, especially in Latin America. The EU would like to see a more unambiguous commitment on the part of the US for IEC standards.

Third, despite the fact that technological development and consumer awareness in this sector favours self-certification by manufacturers, backed up by post-market surveillance and control, third party certification of electrical equipment and appliances is still mandatory (*de jure* and/or *de facto*), in the US market. This is probably the single most burdensome barrier to entry of European electrical equipment and appliances. Technological development and consumer awareness have permitted public regulators in the EU and around the world to reduce the extent of pre-marketing third party testing and certification of these products in favour of self-certification by manufacturers backed up by post-market surveillance. This disparity in conformity assessment creates an uneven playing field in the EU-US trade of electrical goods, accruing disproportionately high costs to suppliers of the US market.

Fourth, it must be noted that the EU was forced to suspend in January 2003 the *Annex for Electrical Safety to the EU-US Mutual Recognition Agreement (MRA*), since all attempts to develop practical solutions and confidence building measures have been rejected by the *Occupational Safety and Health Administration* (OSHA). Under the MRA, European designated laboratories should certify equipment according to US regulations. The OSHA has continuously denied European authorities the right to designate European laboratories to operate under the Annex on Electrical Safety and this behaviour has nullified the benefits of the MRA in this sector.

Fifth, since telecommunications equipment is subject to continuous testing and assessment in its development and production process, it should be unnecessary to repeat such tests by a third party. Industry stresses the advantages of an appropriate "supplier declaration of conformity". US regulatory agencies have begun a review of this approach, and are moving in certain instances towards manufacturer's declarations of conformity (PCs, VCRs, for example).

The Federal Communications Commission (FCC) has deregulated its requirements for wired terminal equipment attachment (much in line with the regulatory approach used in the EU). However, the FCC continues to require third party certification of radio equipment that has been deregulated in the EU in terms of technical product requirements and approval procedures. The FCC is therefore encouraged to move toward a "manufacturers' declaration of conformity" for radio equipment. The current US system has led to an unbalanced market access situation between the EU and US and to various complex type approval systems in the world. If the US will adopt lighter conformity assessment procedures, it will be possible to call upon these regimes to deregulate.

Mobile phones first have to be certified by the PCTRB (PCS Type Certification Review Board) before being allowed access to the networks of US mobile operators. The European Industry reports that manufacturers are also required to have tri-band phones (capable of operating in US and 900/1800 MHz bands) tested by the PCTRB for EU interoperability requirements before receiving approval to access US mobile networks. This results in redundant double testing for European mobile phone manufacturers.

The FCC should be encouraged to ensure that US operators only require certification of US specific operations of mobile equipment or align its regime with the EU regime.

Automotive

The *American Automobile Labelling Act* provides that passenger cars and other vehicles must be labelled with, *inter alia,* the proportion of US and Canadian-made parts and the final point of assembly. These requirements are intended to influence consumers to buy cars of US-Canadian origin. There is also an obligation to indicate the origin of engines and gearboxes that could discourage US manufacturers from importing parts from Europe. Moreover conforming to the labelling requirement may involve the disclosure of confidential data from non-US manufacturers.

Shipbuilding

While the production of cruise ships is almost entirely based in the EU, the most important market for cruises is the US, which makes compliance with US rules mandatory for cruise ship manufacturers. Certain US Coast Guard regulations (i.e. Code of Federal Regulations, Title 46- Shipping) do not approve EU-made equipment on board passenger vessels owing to occupational health considerations. There may be an economic case for extending the scope of the existing MRA on marine equipment, referred to above.

Recreational Marine

The EU adopted in 2003 exhaust emission and noise emission requirements for recreational craft by amending Directive 94/25/EC.

As these EU requirements have entered into application on 1 January 2005, and will be fully applicable for most products as from 1 January 2006, consideration has to be given to amending the sectoral Annex on recreational craft in the EU-US MRA (see above).

The amendment to Directive 94/25/EC also requires the Commission to report by 2006 on the suitability of further improving the environmental characteristics of recreational marine engines and to submit by 2007 legislative proposals to that extent if considered appropriate. Alignment between the future EU and US regulations will be an important element to be taken into consideration. Some exploratory discussions with the US authorities took place in 2003 and 2004, but have not been continued in 2005. The Environmental Protection Agency (EPA) is working towards introducing in the near future exhaust emission values and technical requirements for recreational marine diesel engines that are far more stringent than the actual EU requirements. A discussion with the EU on the possibilities of aligning their future emission regulations with future EU legislation on emissions for recreational craft would be useful.

Pharmaceuticals and cosmetics

In the US, as in Europe, a competent authority (the *Food and Drug Administration* FDA) must approve a new medicinal product before it can be commercialised. However, the delays for non-US new medicinal products appear to be longer than for US developed medicinal products. This may be in part due to the *Investigational New Drug* (IND) system that allows the FDA advanced knowledge of medicinal products tested in clinical trials in the US.

By means of an "over-the-counter" (OTC) procedure, approved active substances for many medicinal products are put on a list (OTC-Monograph) by the FDA, so that different final products derived from these active substances can be marketed without any application or delay. However, the OTC monograph procedure requires that the active substance has a US market history. This restricts market access for OTC products with lengthy marketing experience in countries with equally sophisticated medicines regulatory systems and particularly hampers access for plant-based (herbal) medicinal products with a long tradition in Europe. New provisions clarifying the criteria and procedure for classifying foreign OTC products generally recognised as safe and effective were adopted on 1 April 2002. The main objective of these provisions is the clarification of the criteria under which foreign products may enter the US market. Main criteria are five continuous years of marketing in at least one country outside the United States and a number of further requirements. While the new provisions are welcome in principle, administrative market access hurdles for herbal medicines from Europe still exist. New herbal medicines have not yet been authorised in spite of different attempts of business operators to do so.

The FDA and the EU have re-energised cooperation in cosmetics and certain over-the-counter drugs harmonisation activities under the *Cosmetics Harmonisation and International Cooperation* (CHIC) process. The last meeting took place in March 2005, where new terms of reference to guide future cooperation were developed and approved. In the framework of CHIC, the FDA and DG Enterprise and Industry have exchanged extensively information on this respective regulatory systems, safety concerns, and alternative test methods to animal testing, including the discussion on the establishment of a rapid alert system to exchange data on adverse reactions.

The exchange of information is, however, only a first step: It is equally important that the US and EU authorities take each other's findings into consideration when regulating cosmetic products (including certain over-the-counter drugs) and their ingredients. For example, out of 28 UV-filters which have been approved by the EU for their use in sunscreen products, the US has so far only authorised 15.

The importance of taking each other's findings into consideration holds particularly true for the development of alternative methods to animal testing: The US and the EU have committed to recognise mutually and accept alternative methods to animal testing. To this end, the US Interagency Coordinating Committee on the Validation of Alternative Methods (ICCVAM) and the European Centre for the Validation of Alternative Methods (ECVAM) are collaborating closely on the further development and validation of alternative test methods to animal testing for cosmetic ingredients.

Pressure equipment

At present the trade situation in the pressure equipment sector is subject to an exchange of letters and talks between the European Commission and the US Department of Commerce. On 3 May 2004 a first face-to-face meeting took place in Washington with regard to improving the technical barriers of trade perceived on both sides of the Atlantic.

In the US pressure equipment is regulated on a local level, e.g. by local “jurisdictions”. For some specific pressure equipment used at the work place, this local regulation is complemented by Occupational Safety and Health Administration (OSHA) rules, a department of the federal US Department of Labor. From a European point of view, the regulation on pressure equipment in the US is characterised by the reliance on one particular set of prescriptive national standards for pressure equipment, the American Society of Mechanical Engineers (ASME) code, as a basis for the regulation of most jurisdictions and on one national organisation of vessels inspectors, the national Board of Boiler and Pressure Vessel Inspectors (the National Board).

Although the ASME code is the basis, most of the local “jurisdictions’” regulations complement it by additional and locally slightly different provisions mainly on administrative procedures resulting in what can be perceived as excessive red tape. Moreover, the prescriptive approach of the US legislation impedes innovative approaches to technical problems and grants a *de facto* regulatory monopoly to a private organisation. It is interesting to note that at the meeting in Washington, the US side claimed that pressure equipment legislation on the state/jurisdiction level is considered to have no trade impact and is therefore not notified to the WTO.

A particular problem concerns Welders and Non-destructive testing (NDT) personnel. In order to have their products accepted in the US market, European manufacturers need to have their welders and NDT personal certified according to ASME requirements, which incurs extra costs.

Another problem concerns ASME list of approved materials. While recently a few “European” grades were included in this list, the technical specifications deviate from the European Norms (EN) specification for the same material and the specified strength levels are consistently lower. This means that ASME specifications do not allow exploiting the full performance of EN materials for the design of pressure equipment and as a consequence EN specifications are economically penalised.

Moreover, European pressure equipment manufacturers envisaging to use a particular material for the US market, which is not listed in the ASME code, are faced with significant problems. The only possibility is the so called “code case” procedure that it is very time-consuming, costly and requires a lot of test series and corresponding data.

Many US jurisdictions provide for “state specials”, which are items of pressure equipment that have been granted a (partial) exemption from the ASME code. However, European manufacturers find these exemptions to be prohibitively expensive to obtain and are discouraged by significant administrative delays. During the recent meeting in Washington the US side has confirmed that “state specials” are very rare and in practice not economic for new pressure equipment (i.e. only to be considered if already-existing pressure equipment designed according to a “foreign” code should be brought to the US). Since “state specials” are implemented by State law, any improvement in this respect would require the modification of 50 State laws – a process which is not feasible, moreover since no co-ordinated action can be expected.

The ASME code requires a mandatory initial (and then frequently repeated) inspection of manufacturers (independent of the amount of pressure equipment manufactured) by an

Authorised Inspection Agency (AIA). For foreign manufacturers the AIA has to be an insurance company authorised to write pressure equipment insurance in at least one US jurisdiction, while third-party inspection of US manufacturers may also be performed by local jurisdictions. According to information from the National Board, the future nomination of non-US foreign government agencies as AIAs, which would have to be accredited to ASME criteria, is about to be approved. Although such a change would certainly be a positive development, the mandatory AIA inspection still creates high entry costs to the US market for European manufacturers and there is no analogy imposed by European legislation on US manufacturers. High entry costs particularly penalise small manufacturers producing only limited quantities of pressure equipment for the US market with respect to their US peers.

Textiles and Leather

Extensive product description requirements complicate exports to the US. Rules are burdensome for marking and labelling retail packages to clarify the country of origin, indicate the ultimate purchaser in the US and state the name of the country in which the article was manufactured or produced. Articles that are otherwise specifically exempted from individual marking are an exception to this rule. All textile fibres imported to the US have to be marked with the generic names and percentages by weight of the constituent fibres present in the textile fibre product in amounts of more than 5%. Any wool products containing woollen fibre, with the exception of carpets, rugs, mats, upholsteries and articles made more than 20 years prior to importation, have to be clearly marked so as to satisfy the requirements of the *Wool Products Labelling Act of 1939* (with regard to information on weight and importer). The *Fur Products Labelling Act* imposes similar obligations on fur products.

Agriculture

Grade A Milk Products :

Certain dairy products, called "Grade A milk products" which include fluid milk, cream, cottage cheese and yoghurt, are regulated under a Federal/State cooperative programme administered jointly by FDA and the National Conference on Interstate Milk Shipments (NCIMS) which is mainly comprised of state dairy regulatory officials. FDA and NCIMS jointly produce a Grade A dairy safety document, entitled the Pasteurized Milk Ordinance (PMO), which sets forth the rules and inspection requirements to be met by firms who would like to engage in the interstate commerce of Grade A products

According to an FDA notice published in January 2000, there are three options for firms interested in exporting Grade A dairy products to the US:

- the exporting company must sign a contract with a State, which must accept to treat it as if it were within its own jurisdiction (including the inspection and the control of the observance of the US regulation by inspectors of the State several times per annum);
- or the region/country of the exporting firm must adopt and comply with the US rules, in order to become a member of the Conference;
- or the programme and the regulations in the exporting country are recognised equivalent to the US programme by the FDA.

Only two EU firms have been able to make it onto the NCIMS list, considering the requirement to meet all PMO provisions and to finance the ongoing inspections by US state officials. Upon the European Commission’s request, FDA has agreed to enter into equivalence discussions with the EU and a working plan for these discussions was agreed in October 2005. It is the hope of the European Commission that these discussions can be held expeditiously in order to remedy the present situation in which it is extremely difficult to export Grade A milk products into the US.

Wine Labelling
Some state legislation, which has its origins in Prohibition-era restrictions, impedes the free circulation of alcoholic beverages. The US operates a series of protectionist and monopolistic systems at state level for the distribution and marketing of wines and spirits. Rules still persist in some states that prevent cross-state retail sales of wines and spirits; prohibit EU exporters from distributing, rebottling, or retailing their own wine; require duplicate label approvals; levy fees and charges; and other procedures. In a worrying development in recent years, a number of states, termed the "reciprocal states", have agreed among themselves to facilitate the distribution of wines among themselves, whilst requiring imported wines to continue to be channelled via the more-burdensome procedures and trade-restrictive concessionary networks. While the situation may be eased for US producers following the decision of the US Supreme Court on interstate wine sales (direct shipping) of 16 May 2005, the European Commission is carefully following the implementation of this decision of the Court to assess whether discrimination against imported products may be exacerbated as a result of this implementation.

On 14 September 2005, the agreement on trade in wine between the United States and the EU was initialled. With this agreement, both parties recognise and protect via their labelling rules each other’s wine names. Regarding the 17 EU wines names which are currently considered as semi-generic terms in the US, the US has agreed to seek to change their legal status to restrict their use to EU wines only, notwithstanding a grandfathering clause of existing brand names using these terms. The EU Council of Ministers approved the wine deal at the end of 2005.

US Standards on organic products

Under the 2001 US *National Organic Program* (NOP), a provision exists for imported products to be recognised as organic. The EU and the US have entered into bilateral negotiations with a view to mutually recognising the equivalency of the organic production systems applied by each Party. This should facilitate trade in products originating from organic production methods while ensuring the integrity of the organic production method. While substantial progress had been made in the negotiations for two years, the talks are at a standstill since May 2004 and no further road map has been laid out.

How are these problems being addressed?

The challenge posed by regulatory barriers has been pursued through reliance on the WTO Technical Barriers to Trade (TBT) Agreement, through conclusion of bilateral agreements such as the EU-US Mutual Recognition Agreement (MRA), and through various regulatory dialogues.

The EU believes that the Technical Barriers to Trade (TBT) Agreement provides an excellent basis on which to tackle technical barriers to trade at the multilateral level.

The EU and the US have concluded a *Mutual Recognition Agreement* (MRA), which entered into force on 1 December 1998. Its objective was to facilitate EU-US trade by permitting manufacturers to test and certify their products with a domestic conformity assessment body (CAB) according to the requirements of the other Party. However, the US has not made a sufficient commitment to implementing it, particularly in the areas of pharmaceutical good manufacturing practice.

A further MRA entered into force in 2004 covering the marine equipment sector. This differs from the previous MRA in that it is based on equivalent rules, based on those of the

International Maritime Organisation Conventions which both the US and the Community have accepted for the products covered by the MRA.

Regulatory dialogues can have a wide range of objectives from harmonisation of regulations or standards, recognition of equivalence or developing common or international standards, to identification of best regulatory practices, confidence building or information exchange. Recently, these efforts have been reinforced.

In 2002, voluntary *EU-US Guidelines for Regulatory Co-operation* and Transparency (http://europa.eu.int/comm/enterprise/enterprise_policy/gov_relations/interntl_regul_coop_eu_us/regul_coop_guide.htm) were drawn up to improve co-operation between regulators and to promote transparency for all stakeholders. Following the adoption of the *Guidelines*, initial "pilot projects" represented the first steps in its implementation.

Moving towards a more systematic approach to regulatory co-operation, a first *Roadmap for EU-US Regulatory Cooperation and Transparency* (http://europa.eu.int/comm/enterprise/enterprise_policy/gov_relations/interntl_regul_coop_eu_us/regul_coop_transp_roadmap.htm) was developed in June 2004, expanding the approach to horizontal initiatives while listing a number of specific existing projects and prospective new ones. One of the main ideas is to promote regulatory cooperation before regulating.

Endorsed by the EU-US Summit, the newly developed *2005 Roadmap for EU-US Regulatory Cooperation* lists 15 sector-specific regulatory projects (compared to 10 in 2004) between the US Administration and the European Commission. For all these areas, the roadmap contains the objective, progress and next steps. As a result, the roadmap is now a document that both reports on progress and creates a work programme for US- European Commission regulatory cooperation for the next year. In addition, the roadmap contains horizontal activities, such as the EU-Office of Management and Budget (OMB) dialogue on general regulatory policy issues ("*how we regulate*") with a close link to the better regulation process in the EU and regulatory reforms in the US. The roadmap also attempts to identify resources and mechanisms for EU-US regulatory exchanges.

The 2005 EU-US Summit decisions also established a new EU-US high level Regulatory Cooperation Forum, which will give political support and visibility to regulatory cooperation efforts. The Forum, with its cross-cutting remit, will inject greater width and depth into existing cooperation. It establishes, for the first time, a mechanism to bring together senior US and European Commission officials to exchange views on "*how we cooperate*" on regulatory issues. More importantly, it does not simply create a new process, but will provide impetus for progress on substance.

This informal mechanism should promote enhanced cooperation in line with the 2002 Guidelines, address cross-cutting issues, and should be the focal point for exchanges and discussion of annual regulatory work programmes of both the European Commission and the US administration. This way, moving towards cooperation *ex ante* regulating, the Forum can help identify additional prospective areas for EU-US regulatory cooperation, and facilitate early warning about possible divergent regulatory approaches.

Direct regulator-to-regulator dialogues remain at the core of regulatory cooperation, and the Forum will facilitate such dialogues, while respecting each regulator's autonomy. Regulators will autonomously assess progress for ongoing activities and set objectives with specific actions to be achieved within the coming year. The compilation of these plans, jointly agreed upon by European and US regulators, will constitute priorities for EU-US regulatory cooperation to be submitted annually at EU-US Summits.

The Forum should organise meetings and conferences on regulatory issues of mutual interest. To gain a broader perspective, other regulators as well as representatives from academia, think-tanks, businesses, NGOs and other organisations will be invited to participate, as appropriate.

While there have been important successes in EU-US regulatory co-operation, problems remain. The challenge is to find a mode of regulatory co-operation which instils in regulators the recognition that while their primary focus must remain with their domestic constituencies, they are now also joint stewards and regulators of a transatlantic market.

5.2 Registration, Documentation, Customs Procedures

Excessive invoice requirements

Invoice requirements for exporting certain products to the US can be excessive. The information requirements far exceed normal customs declaration and tariff procedures. They are unnecessary because the US Bureau of Customs and Border Protection (CBP) is entitled to ask for all necessary supplementary documents and information during clearance (as provided for by the Kyoto Convention). There should be no systematic demand for this kind of information. These formalities are also burdensome and costly, thus constituting a barrier against new entrants and small companies. As a result, large established suppliers are privileged and small and new competitors disadvantaged. These effects are particularly disruptive in diversified high-value and small-quantity markets that are of special relevance for the EU.

Lack of recognition of the EU as a Customs Union

The US CBP does not recognise the EU as a country of origin and refuses to accept EU certificates of origin. This means that in order to justify EU country-of-origin status, EU firms are required to furnish supplementary documentation and follow further procedures, which can be a source of additional costs. The European Commission and the Transatlantic Business Dialogue (TABD) have consistently urged the US to recognise a simple EU origin. CBP noted this issue extends the scope of customs policy and that inter-agency consensus did not yet exist. Some US industries and organised labour opposed the change whilst other business had cost concerns (i.e. marketing). For example, tyres imported into the US are required by law to be labelled with their country of origin. If tyres marked "made in the EU" were accepted, market access would be improved and trade less onerous.

Further evidence of the lack of recognition of the EU as a customs union is the US opposition to the EU request to amend the Brussels Convention, creating the World Customs Organisation (WCO), in order to allow it to accede to the Organisation, where it currently has merely an observer status. The main task of the WCO is to enhance the effectiveness and efficiency of Customs administrations by developing and maintaining harmonised international customs standards in the field of areas of mainly exclusive EU competence. In addition, the current situation is not coherent with the full member status of the EU in the WTO, which also deals with several customs issues. Therefore, US opposition to the EU's accession to the WCO may provoke unnecessary delays as regards the adoption of important measures relating to customs and trade facilitation within the WCO.

The US attitude in the aforementioned case contrasts with their attitude at the WTO. In particular, whilst the US does not recognise the EU as a customs union, it at the same time complains before the WTO about an alleged lack of uniform application of customs measures throughout the EU. Thus, a WTO Panel on selected customs matters in the EU is ongoing in Geneva on the request of the US. The Panel report is expected in April 2006.

Bioterrorism Act of 2002

The FDA has implemented four far-reaching rules to implement the food-related provisions of the *Bioterrorism Act of 2002,* passed by Congress in order to address the threat of bioterrorism. These comprise registration of all foreign facilities that supply food to the US; prior notification of all shipments to the US; record-keeping by foreign enterprises to allow traceability of foods; and procedures for the administrative detention of suspect foods. The European Commission has made representations to the US on all measures, highlighting the lack of a specific risk assessment and severe burdens on trade. US authorities have themselves predicted that the measures on registration of foreign facilities will reduce by as much as 16% the number of firms exporting food and feed to the US. In addition, FDA estimates that the financial burden of other measures will fall disproportionately on foreign suppliers. In its comments, the European Commission has argued that the US should use the full scope of its capacity for flexibility to reduce the impact of the measures on trade and set up an urgent review of the parent legislation from the beginning of its operation. The European Commission has repeatedly stressed the need for transatlantic consultation on these issues since increased US-EU coordination on how to address potential terrorist threats to the food supply would be more effective. The administrative burdens have forced smaller operators to cease their exports to the US. It has also become clear that the requirement of a US agent serves no useful purpose taking into account the objectives of the Act and that while the international mail deliveries by private individuals now seem to be exempted, foreign mail order companies are still subject to these burdens. Clearly the additional red-tape resulting from the implementation of the Bioterrorism Act does affect EU agri-food business in particular small and medium enterprises.

Container Security Initiative (CSI)

The US launched the *Container Security Initiative* (CSI) in 2002 as a response to US concerns involving potential terrorist threats to the international maritime container trade system. The CSI consists of four elements: security criteria to identify high-risk containers; pre-screening containers before they arrive to US ports; using technology to pre-screen high-risk containers and developing and using smart and secure containers. The US CBP launched the system to achieve a more secure maritime trade environment while attempting to accommodate the need for efficiency in global commerce. Ports participating in the CSI use technology to assist their officers in quickly inspecting high-risk containers before they are shipped to US ports. So far, ten Member States have signed declarations of principle with the CBP to introduce CSI in their ports as well as an agreement on stationing US Customs officials in their ports.

In order to ensure a level playing field among European ports, the EU concluded an agreement that expands the EU-US customs co-operation agreement to include transport security aspects and to prepare minimum standards for all EU ports to participate in the CSI. In August 2005, the US agreed to participation in the CSI of further EU ports, which comply with certain jointly agreed minimum standards and where no US officials will be stationed. The EU and the US are currently examining which ports qualify for participation. The EU-US working group established by the expanded agreement adopted also joint control standards and a joint threat assessment. It is furthermore currently working on further measures like a joint list of risk rules, a comparison of trade partnership programmes and EU-US data elements that will aim to create for US and EU operators equal levels and standards of controls and thus to facilitate legitimate trade in the transatlantic movement of goods. The agreement aims to improve security on a reciprocal basis for both the EU and the US and to achieve mutual recognition of security measures and business partnership programmes.

Importantly, by ensuring EU-level co-operation with the US, differential treatment of EU Member States and hence trade diversion within the EU will be prevented.

According to the European Engineering Industry, the CSI screening and related additional US customs routines are causing significant additional costs and delays to shipments of EU machinery and electrical equipment to the US. This burden is so severe that a number of small European engineering companies have decided not to export to the US any longer because of CSI. There is also competitive distortion in this fiercely competitive engineering market between EU and US engineering companies since up to now there is, *de facto,* no reciprocity between the EU and the US in this issue.

On 20 November 2003, the CBP transmitted the final *Trade Act of 2002* regulations to Congress and they were published in the Federal Register on 5 December, 2003. The regulations provide for various data on cargo to be transmitted to the CBP through an electronic data interchange system of information. The regulation concerns data on cargo that is brought into or taken out of the US prior to arrival or departure of the cargo. The regulation sets different timeframes for delivering these data to customs, depending upon the mode of transportation.

It is hoped that the forthcoming customs co-operation with the US will allay concerns that these US initiatives could lead to the distortion of traffic and transport and trade patterns, thereby causing problems for the European Single Market.

Customs Trade Partnership Against Terrorism

In addition to the CSI, and in an attempt to involve the business community more directly in the fight against terrorism, the US Government launched the Customs-Trade Partnership against Terrorism (C-TPAT) scheme in 2003. This is a joint government-business initiative to build co-operative relationships in order to strengthen overall supply chain and border security. Essentially this is achieved by asking businesses to ensure the integrity of their security practices as well as those of their business partners within the supply chain. Through specific security guidelines manufacturers assume the obligation to develop and implement a number of measures designed to develop a secure framework for manufacturing, production, cargo storage, handling facilities and transportation. The measures to be implemented cover physical security, access controls, procedural security, personal security, education and training, etc.

Following its initial membership limited to US-based manufacturers/importers, the CBP is now in the process of expanding the C-TPAT to overseas manufacturers. Since the end of August 2003, the CBP has enrolled an initial phase for expansion of the C-TPAT for foreign companies. The programme is now open for Mexican manufacturers who will be invited by the CBP to participate.

To the extent that participation to the C-TPAT scheme entails as yet rather unclear advantages related to customs controls and inspections, the EU is concerned that the CBP's approach would result in a situation where EU Member States and companies would be treated differently, leading in turn to the very real possibility of trade distortions. There is also concern that the foreign version of C-TPAT would impose on participating foreign exporters the requirement to provide more extensive information than that asked of domestic importers, raising further questions on the scheme's cost burdens and discriminatory nature. This would constitute a violation of the Most-Favoured Nation (MFN) principle of non-discrimination as embodied in GATT Article I:1. The EU urges the US CBP to implement the C-TPAT in an even-handed way in a spirit of co-operation, so as to ensure equality of treatment between US-based C-TPAT members and foreign commercial interests. The forthcoming work of the

EU-US expert group (as mentioned above under CSI) on benchmarking of US and EU standards for authorised traders should deliver recommendations for mutual recognition of industry partnership programmes.

Textiles and Leather

Customs formalities for imports of textiles, clothing and footwear to the US require the provision of particularly detailed and voluminous information. These requirements lead to additional costs and in some cases include confidential processing methods (type of finishing, of dyeing, etc). Much of this information would appear to be irrelevant for customs or statistical purposes. For example, for garments with an outer shell of more than one construction or material, it is necessary to give the relative weight, percentage values and surface area of each component; for outer shell components which are blends of different materials, it is also necessary to include the relative weights of each component material.

The extension of the liquidation period up to 210 days also functions as an important trade barrier. Apparel articles often have a short life span (e.g. fashion items must be sold within two to three months) and therefore have to be marketed immediately. Consequently, the retailer or the importer is often not in a position to re-deliver the goods upon CBP's request, in which case CBP applies a high penalty (100% of the value of the goods). According to importers, CBP may extend the liquidation period beyond 210 days without giving a detailed motivation. In some cases a minor problem or error in invoice is sufficient. In addition, during the liquidation period, Customs may still request any additional information necessary to establish the classification and the country of origin.

Fisheries

The *US Code, Title 46, Shipping, Section 12108*, prevents EU fishermen from fishing in US waters under the US flag as foreign-built vessels are not eligible to receive a fisheries licence. This situation also precludes the possibility of joint ventures and joint enterprises. In addition, the *American Fisheries Act of 1998* included a provision that increased the percentage of shares in a vessel that must be held by US citizens in order for the vessel to be considered a US vessel from 50% to 75%.

5.3 State Level Impediments to Trade

Regulatory differences at State level

There are more than 2700 State and municipal authorities in the US that require particular safety certifications for products sold or installed within their jurisdictions. These requirements are not always uniform or consistent with each other, or even transparent. In particular, individual States sometimes set environmental standards going far beyond what is provided for at federal level. Agricultural and food imports (particularly wines, see "Agriculture: Wine Labelling", Chapter 5 Non-Tariff Barriers, section 5.1 Technical regulations, Standards and Conformity assessment procedures) are also often confronted with additional state-level requirements.

Acquiring the necessary information and satisfying the necessary procedures is a major undertaking for a foreign enterprise, especially a small or medium sized one, as at present there is no central source of information on standards and conformity assessment. One company has estimated the volume of lost sales in the US due to the multiplicity of standards and certification problems to be about 15% of their total sales. The expense of certification alone was put at 5% of total sales, as was the amount spent on product liability insurance (a far less significant factor in Europe).

The hidden costs could be much greater because the time and cost involved can be greatly reduced simply by using US components that have already been individually tested and certified. This is particularly the case for electrical products.

In addition, the private organisations providing quality assurance may impose the use of certain specific product components under their own programmes that are not in conformity with international quality assurance standards (such as the ISO 9000 series). In some cases an expensive evaluation procedure is required which does not lead to certification and does not take account of any additional requirements by individual buyers.

There are many other cases where state-level impediments are an issue (see Section 5.7 on Public Procurement; Section 5.10 on Sudsidies; and Section 6.2 on Tax Discrimination for example).

5.4 Levies and Charges (other than Import Duties)

User Fees

There is a series of user fees by which the user of a particular (formerly free) service pays an amount presumed to cover the cost of the service provided.

As a result of laws enacted in 1985 and 1986, the US imposes user fees on the arrival of merchandise, vessels, trucks, trains, private boats and planes, as well as passengers. The *Customs and Trade Act of 1990* and the *Omnibus Budget Reconciliation Act of 1990* modified these provisions by, among other things, considerably increasing the level of the fees. Excessive fees levied for customs, harbour and other arrival facilities (facilities mainly used by importers) place foreign products at a disadvantage vis-à-vis US competition.

The most significant of the customs user fees is the *Merchandise Processing Fee* (MPF). The MPF is levied on all imported merchandise except for products from the least developed countries, from eligible countries under the *Caribbean Basin Recovery Act* and the *Andean Trade Preference Act*, and from US offshore possessions. It is levied also on merchandise entered under Schedule 8, Special Classifications, of the Tariff Schedules of the US. Fixed previously at 0.17% of the value of the imported goods, the MPF rose to 0.19% in 1992 and amounts to 0.21% *ad valorem* on formal entries with a maximum of $485 as from 1 January 1995. Whilst the MPF was to last until 30 September 1990 when established, it was recently extended (as part of the *American Jobs Creation Act of 2004*) until 30 September 2014.

At the request of Canada and the EU, the GATT Council instituted a Panel in November 1987 that stated that the US Customs user fees for merchandise processing were not in conformity with the General Agreement. The Panel ruled that customs user fees should reflect the approximate cost of customs processing for the individual entry in question. This principle was not met by an *ad valorem* system such as that used by the US. The GATT Council adopted the Panel report in February 1988.

The present customs user fee structure is somewhat more equitable, since the fixing of a ceiling makes it less onerous for high-value consignments. However, the fee is still likely to exceed the cost of the service since it is still based on the value of the imported goods.

Harbour Maintenance Tax and Harbour Services Fee

The CBP also participates in the collection of the *Harbour Maintenance Tax* (HMT). The HMT is levied in all US ports on waterborne imports, at an *ad valorem* rate of 0.125%. Collected monies are transferred to the Harbour Maintenance Trust Fund to provide for the operation and maintenance of channels and harbours. However, the *ad valorem* basis for the HMT collection makes it difficult to justify as a fee approximating the cost of the service provided. Moreover, there is a significant accumulation of unused funds, which reached $1.609 billion in Fiscal Year 1999 and has risen further since. This rise points to the excessive nature of the HMT.

The US Court of International Trade in October 1995 ruled that under US law the HMT is a tax and not a user fee. The US Constitution prohibits taxes on exports. The US Court of Appeals confirmed this ruling in June 1997 as did the US Supreme Court in March 1998. As a result, the US authorities have stopped collecting HMT on exports. However, the HMT is still being collected on imports.

Shipbuilding

The US applies a 50% *ad valorem* tax on non-emergency repairs of US-owned ships outside the US and on imported equipment for boats, including fishnets on the basis of Section 466 of the Tariff Act of 1930, as amended in 1971 and 1990. Under the latter amendment the tax would not apply, under certain conditions, to foreign repairs of “LASH” (Lighter Aboard Ship) barges and spare vessel repair parts or materials. However, as the “LASH” technology is not widely used outside the US, the exemption is of limited relevance.

Automotive

The US levies the following two taxes/charges on the sale of cars in the US that raise concern to European automakers: the Corporate Average Fuel Economy (CAFE) payment and the so-called Gas Guzzler Tax.

The CAFE payment is a civil penalty payment levied on a manufacturer or importer whose range of models has average fuel efficiency below a certain level, currently 27.5 miles per gallon (mpg). CAFE favours large integrated automakers or producers of small cars rather than those who concentrate on the top end of the car market, such as importers of European cars.

The so-called Gas Guzzler Tax is an excise tax of $1,000 – $7,700 per car, levied on all cars not meeting fuel economy standards set by the *US Environmental Protection Agency* (EPA), currently 22.5 mpg. This fuel economy cut-off point is not founded on any reasonable or objective criterion and leads to discrimination against imported cars.

According to the latest estimate available, European-based auto makers, with a total market share in the US of only 9%, bear 85% of the revenue generated by the Gas Guzzler Tax and almost 100% of the CAFE penalties.

5.5 Import Prohibitions

National Security based restrictions

The right of sovereign nations to take measures to protect their essential national security interests has been widely recognised by multilateral and bilateral trade agreements and, of course, particularly since the events of 11 September 2005. However, it is in the interest of all trade partners that such measures are prudently and sparingly applied. Restrictions to trade and investment cannot be justified on national security grounds if they are, in reality, essentially protectionist in nature and serve other purposes.

Under *Section 232 of the Trade Expansion Act of 1962*, US industry can petition for the restriction of imports from third countries on the grounds of national security. Protective measures can be used for an unlimited period of time. The *Department of Commerce* (DoC) investigates the effects of imports that threaten to impair national security either by quantity or by circumstances. Section 232 is supposed to safeguard US national security, not the economic welfare of any company, except when that company's future may affect US national security. The application of Section 232 is not however dependent on proof of injury to US industry.

In the past, the EU has voiced its concern that Section 232 gives US manufacturers an opportunity to seek protection on grounds of national security, when in reality the aim is simply to curb foreign competition. On 1 February 2001, the DoC initiated an investigation to determine the effects on national security of imports of iron ore and semi-finished steel. The DoC released its report on 9 January 2002, which found that imports of iron ore and semi-finished steel do not threaten to impair US national security. Therefore no action under Section 232 to adjust the level of imports was recommended to the President.

Agriculture and Fisheries

<u>The 1972 Marine Mammal Protection Act</u>

The *Marine Mammal Protection Act of 1972* (MMPA) aims at protecting marine mammals, particularly dolphins, by progressively reducing the acceptable level of dolphin mortality in US tuna-fishing operations in the Eastern Tropical Pacific (ETP) Ocean and providing for sanctions to be taken against other countries which fail to apply similar standards.

The MMPA requires that countries that wish to import from the ETP must receive an "affirmative finding" from the National Marine Fisheries Service (NMFS). The criteria for receiving an "affirmative finding" relate to the membership (or launching and completing the accession within six months) to the Inter-American Tropical Tuna Commission (IATTC) and the need to have a "tuna tracking and verification system" that conforms to the Tuna Tracking and Verification System adopted under the Agreement for International Dolphin Conservation Programme (AIDCP).

The EU has provisionally applied the AIDCP since 1999 pending completion of procedures required for its official accession to the IATTC. The AIDCP was formally approved by the EU by Council Decision 2005/938/EC of 8 December 2005. The EU introduced a Tuna tracking and verification system into Community law by means of Council Regulation (EC) N° 882/2003 of 19 May 2003. The EU has made a request to become a party to the IATTC but this is pending the signature and ratification by all parties to the Agreement of a protocol to the agreement that would allow the European Commission to join. However, this has taken longer than the six months foreseen in the US legislation due to reasons beyond the control of the EU.

The EU, by Council Decision 1999/405/EC of 10 June 1999, authorised Spain to join the IATTC, on a provisional basis, and under the condition that Spain participates in the decision-making process of the IATTC in line with the EU position and in close consultation with the European Commission. In 2003 in Guatemala, the negotiations on the new IATTC Convention text were successfully closed, and the new IATTC Antigua Convention was opened for signature. The EU signed the new Convention on 13 December 2004 and is now in the process of ratifying it. The new IATTC Antigua Convention will enter into force 15 months after the deposit of the seventh instrument of ratification or accession of the Parties to the 1949 IATTC Convention. Once the new IATTC Convention has been ratified by the EU and entered into force, the EC will finally be able to become a full member of the IATTC. When this occurs, Spain, which acceded to the old IATTC Convention in June 2003, will in consequence withdraw.

Import ban on harp-seal fur coats.

The harp seal is not an internationally recognised endangered or threatened species. The international trade regime set out in the GATT, to which both the United States and the EU are parties, dictates that import embargoes are prohibited except in limited circumstances. While the United States can freely prohibit its own citizens from producing harp-seal fur coats, this freedom does not provide a justification for prohibiting the importation of harp-seal fur coats. Distaste for a product is not covered by the GATT "no-import - prohibition" rule. The exceptions that arguably might justify the US action - protection of animal life, protection of public morals or conservation of natural resources – do not count. The US import embargo on harp-seal fur coats is inconsistent with GATT and should be changed to bring it into conformity with US international obligations.

5.6 Sanitary and Phytosanitary Measures

Overly-strict US Sanitary and Phytosanitary requirements, notably those related animal and plant health, have a significant impact on EU exports of agricultural products to the US market. Moreover, many US inspections in the EU continue to take place on a frequent basis and are not carried out in a risk based manner.

Restrictions on Imports of Meat and Other Animal Products

Despite the adoption of the *EU-US Veterinary Equivalence Agreement (VEA)*, in force on 1 August 1999, EU producers of meat and other animal products face numerous barriers of entry into the US market, notably restrictions related to disease-control that either do not have scientific basis, do not follow the recommendations of the *World Organisation for Animal Health* (OIE), or are taken without due regard to the principle of regionalisation, embedded in the Veterinary Agreement itself.

<u>US restrictions related to control of animal disease</u>

Since 1997, the US has taken a very hard-line approach to the import of ruminant animals and products thereof from all European countries which have had cases of *Bovine Spongiform Encephalopathy* (BSE). As a result, exports of beef from the EU are prohibited. As the US now freely acknowledges, since it discovered its first own BSE case in December 2003, these requirements are not scientifically based and do not follow the Organisation Internationale Epizootique (OIE) Code.

Since the US has also encountered unjustified and disproportionate reactions by third countries in response to its own BSE findings, it has worked closely with the EU under the auspices of the OIE to advocate for a new, proportionate and science-based approach towards BSE, which was agreed to in the OIE’s 2005 General Session. The OIE recognizes even more clearly now that there is a list of products, including boneless beef from cattle 30 months and younger, which can be safely traded from any country regardless of whether it fits into the neglible, controlled or unknown risk categories.

The US has begun to change its domestic regulations already prior to implementing the newly agreed OIE Standards. It has reopened its market to Canadian beef and cattle under its new so-called minimum risk rule and published a final ruling in December 2005 which would open the US market to boneless beef from cattle of any age from Japan.

Given the new OIE standards and the fact that the US has already opened its market to Canadian beef and is doing so for Japanese beef, there is no reason as to why beef from the EU should continue to be banned in the US. The European Commission has made the request to export beef to the US on several occasions, most recently in a formal request to the US Department of Agriculture (USDA) Animal Plant and Health Inspection System (APHIS) in October 2005.

Quite apart from the BSE restrictions, the US also imposes animal health restrictions on the import of goats on the grounds of the risk of scrapie in sheep. These restrictions are not justified because of the widespread presence of scrapie in the US sheep population.

<u>Non-recognition of the principle of regionalisation</u>

The EU veterinary legislation, completed under the Single Market programme, provides for a policy of *regionalisation*. According to this policy, in case of an animal disease outbreak, restrictions are applied to the zones affected, with free movement for animals and products outside the affected zones. Only animals or products from non-affected zones can be considered fit for export under certain conditions. The EU applies the principle of regionalisation in its approach towards animal diseases in third countries, including the US. The SPS Agreement also includes a requirement (Art. 6) that members recognise the concept of pest- or disease-free areas of low pest or disease prevalence rather than countries as a whole. Article 6 of the EU-US Veterinary Equivalence Agreement (VEA) actually goes further than the requirement to recognise regions as such - it calls upon the importing party to recognise the regionalisation decisions taken by the exporting Party. The EU routinely employs this approach when faced with limited outbreaks in foreign countries, most recently concerning outbreaks of Exotic Newcastle Disease in some US states.

In 1997, the Animal Plant and Health Inspection System (APHIS) adopted a new policy incorporating concepts of regionalisation based on risk assessment as required by the SPS Agreement. The implementation of this policy involves evaluating the risks presented by the proposed importation of animals and animal products on a range of characteristics of the region from which they are exported, rather than on disease-free or affected statuses being determined on a country basis. The US, however, has not made use of this approach vis-à-vis EU Member States. A major incentive for the EU in the EU-US Veterinary Agreement (VEA), signed in 1999, was the hope that this would lead the US to implement regionalisation decisions. Article 6 of the VEA actually goes further than the requirement to recognise regions as such, as it calls upon the importing party to recognise the regionalisation decisions taken by the exporting Party.

However, the US has failed repeatedly to apply the regionalisation provisions of the Veterinary Agreement, most recently in the case of Foot and Mouth Disease (FMD), where restrictions were imposed on the whole of the EU although the disease had occurred in four Member States only. Although US restrictions were finally lifted for all EU countries, the US did not follow the OIE rule to lift the ban in the affected EU Member States after a three month period of no outbreak of FMD.

Some six years after the signing of the VEA, the US has made some progress in being able to recognise regions in the EU with regard to their animal health status with the publication in

April 2005 of a notice of availability on administrative units in the EU's pre-enlargement 15 Member States (EU-15) (the administrative units for France and Spain had already been identified in 2004). As far as actually following the EU's regionalisation decisions and thus abiding by Article 6 of the VEA, the US has proposed to do so for the EU 15 and for Classical Swine Fever (CSF) only in a proposed rule published in April 2005 – the timing for finalising this rule remains unclear. In comments submitted on the proposed rule, the European Commission stressed the EU's desire to see this rule expanded to cover the entire EU 25 Member States and all major animal health diseases.

APHIS has indicated its intention to follow the EU-15/CSF rule with a more comprehensive rule which would allow it to follow the EU's regionalisation decisions for all member states and all major animal diseases, but is unable to give clear indications on when such a proposed rule might be published. Upon publication, a proposed rule can take several years to complete.

<u>Non-cominglement requirements</u>

"Non-cominglement" means that establishments exporting meat or meat products to the US may not handle meat or meat products from countries that are not recognised as being free from certain diseases of concern to the US, and that there is no mixing of meat or meat products destined for the US with meat or meat products from such countries. The EU-US Agreement on Application of the Third Country Meat Directive provides for an establishment to handle both categories of meat or meat products provided that there is a separation in time between handling them. So far, however, the US has not been willing to apply this provision of the agreement. The EU-US Veterinary Agreement includes also specific provisions for the application of non-cominglement.

<u>Restrictions on imports of uncooked meat products</u>

Imports into the US of uncooked meat products (sausage, ham and bacon) have been subject to a long-standing prohibition. Following repeated approaches by the EU, US import regulations were modified to permit the import of Parma ham, Serrano hams, Iberian hams, Iberian pork shoulders and Iberian pork loins. However, the US still applies a prohibition on other types of uncooked meat products (e.g. San Daniele ham, German sausage, Ardennes ham) despite the fact that meat products may come from disease-free regions and that the processing involved should render any risk negligible.

<u>Plants in growing media</u>

The provisions on standards and certification of plants established in growing media (Code of Federal Regulation (CFR) 1996, Title 7, Subtitle B, Ch.III, §319-37-8) were last revised and effective on 3 November 1999 to permit the import into the US of certain plant genera in sterile growing media. This has reduced the obstacles encountered by EU exports of potted plants to the US.

However, the new rule contains some requirements that are difficult for exporters to fulfill; eg. it is impossible to satisfy certain obligations because some of the species or genera have a growth cycle that is shorter than the waiting period required by USDA before export can take place.

Almost all sorts of plants and growing media (except soil) are permitted for import. However, when the permitted plants are in permitted growth media the import is not permitted, unless a special Pest Risk Assessment (PRA) has been performed by USDA´s Animal Plant and Health Inspection Service (APHIS). The process of obtaining PRA has proved to be extremely slow.

Approval of new non-manufactured agricultural products

For new non-manufactured agricultural products, there are requirements for import permits to the US. The procedures between application and the inclusion in the list of approved products can take several years. This has been experienced even when other products from the same area of production with the same phytosanitary risks were permitted.

Cumbersome inspection and approval procedures

A variety of EU exports to the US have encountered problems due to delays in US Customs sampling and inspection procedures, resulting in damage to the goods and subsequent commercial losses for the exporters. The EU does not dispute the right of the US authorities to inspect imported goods but considers that adequate steps should be taken to deal expeditiously with perishable goods.

Some specific examples of difficulties encountered by EU exports due to the stringent inspection requirements imposed by US regulations are given below.

The import of *egg products* is conditioned to the performance of a continuous inspection of the production process. A system of periodic inspection would be acceptable from a human health point of view, but continuous inspection is disproportionate and expensive, and has a negative effect on prices and competitiveness.

Finally, the import of *Low Acid Canned Food* such as fisheries products or dairy products is subject to a detailed prior approval system, which makes no provision for accepting such products produced under “equivalent” hygiene conditions.

Furthermore, problems have been encountered for EU products held at the Borders Inspections Posts. There are no time limits or procedures for imported products, resulting in many cases in undue delays by the FDA during the process of sampling imported products. The financial impact is even worse in the case of perishable products and there is discrimination in respect to domestic products (which are held under another procedure: administrative detention (Bioterrorism Act). FDA laboratory sampling and testing capacity has not increase in parallel to the activities related to food imports, inspections, and sampling, causing long delays before food and feed products are released. The incurred costs for cold storage or warehousing are at the expense of the exporter. In addition, there is a lack of transparency and information on US rules and administrative procedures to private stakeholders.

Problems have been encountered by EU exporters concerning the Import Alert System as well.

Restrictions on imports of citrus products

One undue obstacle is the restriction, in the case of approved citrus consignments, of the ports of landing to those on the North Atlantic shores. This requirement leads to unnecessary costs of land transport into the southern and western parts of the US. If the products were pre-cleared in the Member State of production, and moreover subject to cold-treatment during transport, there would be no phytosanitary justification for the port restriction.

Restrictions on imports of plants and nursery stock

First, the EU has raised on several occasions its concerns about US rules and administrative procedures governing the phytosanitary legislation, adversely affecting international trade. As a general and as well as a specific trade issue, the EU has faced the problem of access to the US market for potted plants in growth medium, which has been pursued in bilateral contacts between EU Member States and the US for the last 25 years.

Finally APHIS has published the draft proposed rule on the *"Importation of Christmas cactus and Easter cactus in growing media from the Netherlands and Denmark"* via document G/SPS/N/USA/1059 on 20 April 2005. This draft rule proposed the inclusion of Rhipsalidosis spp and Schulembergera spp for Netherlands and Denmark into the (conditional) positive list of plants established in approved growing media that may be imported into the US. The European Commission has sent technical observations to the US authorities according to the procedures and has taken the opportunity to ask for US' consideration that new applications for similar species, production system, or similar country pest status, should be treated just as an extension of this proposed rule.

The EU expects that the USDA will publish the Final Rule as soon as possible so that trade can be finally resumed and EU exporters will profit of better access to the US market.

Second, the USDA is considering a revision of the rules governing the importation of plants, seeds and propagating material into the US. Currently, these plant products can be imported into the US without a permit, and imports can only be restricted after a pest risk analysis. APHIS of the USDA wishes to harmonise and update its rules on the importation of these plant products, and to bring them more in line with the rules for imports of fruit and vegetables (which can only be imported after an import permit is issued).

Thus, on 2 May 2005, APHIS published a Proposed Rule (7 CFR Part 319), advising the public that APHIS would hold a meeting concerning the possibility of establishing a category of plant taxa excluded of pending pest risk analysis with respect to the importation of plants for planting. The meeting took place on 25 May 2005, and the aim was to discuss the criteria that could be used to add plant taxa into that category.

The EU expects to follow closely this new initiative bearing in mind that making everything subject to a permit or a risk evaluation (which can take years), would almost close down trade.

5.7 Public Procurement

In the field of public procurement, the main trade barriers in the United States are contained in a wide array of clauses in Federal, State and local legislation and regulation giving preference to domestic suppliers or products, or excluding foreign bidders or products altogether ("Buy American"). In addition, there are Federal restrictions on the use of Federal grant money by State and local government ("Buy America"). Taken together, these restrictions cover a significant proportion of public purchasing in the US. However, as the US International Trade Commission noted in its 2004 report *"The Economic Effects of Significant U.S. Import Restraints"*, the complexity and partially overlapping nature of the existing restrictions make it nigh-impossible to determine the total value of government-purchased imports subject to these restrictions.

GPA coverage

The plurilateral WTO *Government Procurement Agreement* (GPA) covers a substantial but not yet satisfactory level of public procurement. Many of the market access restrictions experienced by EU suppliers in accessing procurement opportunities in the US could be addressed by increasing the US coverage in the GPA and by eliminating the exceptions which currently narrow the United States' GPA commitments.

The on-going review of the GPA offers a good opportunity to improve the situation. In autumn 2005, the EU tabled an ambitious offer in respect of its own commitments. This offer is however conditional on other Parties to the GPA matching this level of ambition. Regrettably, the U.S. initial offer of 22 December 2005 fails to match the EU's ambitious offer and needs to be considerably improved during the course of the forthcoming market access negotiations.

Buy American: domestic preference as the principle

The *Buy American Act* (BAA), initially enacted in 1933, is the core domestic preference statute governing US procurement. It covers a number of discriminatory measures, generally termed "Buy American restrictions", which apply to government-funded purchases. The *Executive Order 10582 of 1954*, as amended, expands the scope of the BAA in order to allow procuring entities to set aside procurement for small businesses and firms in labour surplus areas, and to reject foreign bids either for national interest or national security reasons.

Some of the Buy American provisions prohibit public sector bodies from purchasing goods and services from foreign sources; some establish local content requirements, while others still extend preferential price terms to domestic suppliers. For example, Federal agencies are required to procure only US mined or produced unprocessed goods, and only manufactured goods with at least a 50% local content. In terms of price preferences, typically a 6% penalty would be added on the bid of a foreign firm for civilian projects; a 12% penalty for such projects when the local competitor is a small enterprise from an area with high unemployment; and a 50% penalty in the case of defence contracts.

Buy American restrictions not only directly reduce the opportunities for EU exports, but via content requirements also discourage US bidders from using European products or services. The US industry, through the court system and legislative lobbying, ensures that Buy American preferences are vigorously enforced and maintained.

Suppliers based in countries that are parties of the GPA are generally not directly excluded from the scope of the BAA and other restrictive regulations. Instead, legislation generally foresees the granting of waivers as regards these suppliers (*inter alia*, through the *1979 Trade Agreements Act*). However, the actual implementation of these waivers may lead to legal uncertainty and act as a barrier.

Buy America: use of Federal grants for infrastructure projects

In addition, significant barriers of access to the US procurement market result from Buy America provisions which prescribe which products State or local authorities can purchase for projects co-funded by Federal grants. The European Commission estimated Buy America to affect about $25 billion of contracts in Fiscal Year 2001, expected to rise to about $35 billion by 2005.

One of the most obvious areas of Buy America is federal aid administered by the *Department of Transportation* (DoT) under several different acts, including *the Highway Administration Act*, the *Urban Mass Transit Act*, and the *Airports Improvements Act*. In accordance with these acts, the DoT provides aid to the State and local governments for various transportation-related procurements. The Federal government may fund 40% to 80% of the project (depending on the nature of the grant), while the State or local government must fund the remaining share. All purchases of goods and services related to these projects must meet various Buy America provisions, usually domestic content requirements of 60% and, failing that, a price penalty of up to 25%. Typically, these provisions also require that all iron, steel and other manufactured goods have to be assembled and originate in the US.

Annual authorisation / appropriations process

Congressional efforts to further restrict foreign procurement are an annual occurrence as part of the authorisation and/or appropriations process. The 2003 and 2004 US Trade Barriers Reports contain ample illustrations with respect to the relevant reporting periods. Some of the proposed amendments raised concerns as to their compatibility with the GPA. One example in this respect is Section 647 of the Appropriations Act for Fiscal Year 2004 which prohibited the performance of services outsourced by US Federal Agencies outside the US. The measure was in force until September 2004. The Federal Government, for its part, when using FY2005 funds, attempts to improve its access to commercial information technology by setting aside the restrictions on purchasing non-domestic products set forth in the BAA, pursuant to Section 517 of the *Consolidated Appropriations Act of Fiscal Year 2005*. The European Commission will continue to closely monitor developments in this respect.

In 2005, the defence authorisation and appropriations process for FY2006 was no exception to this trend. A number of proposed provisions raised concerns: language related to beneficiaries of alleged foreign subsidies and language contained in the House version of the bill that would establish a five-year ban on procurement from any person selling items on the US Munitions List to China. These worrisome provisions were dropped from the final version of the bill. The White House issued Statements of Administrative Policy arguing in favour of keeping flexibility in applying the BAA.

Procurement by the US Department of Defense

The *Department of Defense* (DoD) also has significant procurement expenditures that exclude foreign suppliers of goods or services. The DoD is the largest public procurement agency within the US government, spending many tens of billions of dollars annually on supplies and other requirements. Except as required by the *Defense Supplement to the Federal Acquisitions Regulation* (DFARS), contracting officers must apply BAA requirements to supply contracts exceeding the $2,500 micro-purchase ceiling and to service contracts that involve finishing of supplies when the supply portion exceeds the micro-purchase ceiling. In March 1999, the Director of Defense Procurement reminded US defence agencies and military departments to ensure that their contracting officers comply with requirements of the BAA, as an audit report had revealed that some contracts had been awarded to foreign firms in contravention of the relevant provisions.

Many procurements fall under "national security" exceptions to open procurement obligations. Although the concept of national security can be invoked under *Article XXIII of the GPA* to limit national treatment in the defence sector for foreign suppliers, the use of national security considerations by the US has led to a disproportionate reduction in the scope of DoD supplies covered by the GPA. While the US denies abusing the WTO national security exemption, the EU welcomes that the US has indicated a readiness, in the context of the implementation of the GPA, to give more guidance to US procurement officials for identifying which procurements are covered by the Agreement and which by national security exemptions. It has also expressed its intention to ensure clear and consistent identification of national security procurements, and improve the coherence of the US Federal Supply Classification System with the international Harmonised System.

Berry Amendment

The concept of "national security" was originally used in the *1941 Defense Appropriations Act* to restrict procurement by the DoD to US sourcing. Now known as the "*Berry Amendment*", its scope has been extended to secure protection for a wide range of products only tangentially-related to national security concerns -- for example, the 1992 General Accounting Office ruling that the purchase of fuel cells for helicopters is subject to the Berry Amendment fabric provisions, and the withdrawal of a contract to supply oil containment booms to the US Navy because of the same textile restrictions. In response to an audit report by the DoD's Office of Inspector General covering certain DoD procurements during fiscal years 1996 and 1997, the DoD's procurement director has taken steps to ensure that contracts at or above the simplified acquisition threshold (presently $100,000) are domestically sourced. To comply with the Buy American provisions, contracting officers must generally add 50% to the price when evaluating offers with non-qualifying country end products against offers with domestic end products. In September 1996, Congress adopted an amendment that extended the initial scope of the Berry Amendment to cover also all textile fibres and yarns used in the production of fabrics. The result of this extension was that EU fibres and yarns could no longer be used by US manufacturers for producing fabrics that they sell to the DoD. In 1998, a waiver allowing the procurement of para-aramid fibres and yarns under certain conditions was adopted through the *National Defense Authorization Act for Fiscal Year 1999* (Strom Thurmond Act).

The FY2006 Defense Authorization bill (Section 833) contains changes to the Berry Amendment that expand the coverage of this amendment's Buy American provisions. The new language requires DoD to notify Congress within seven days if it awards a contract to a foreign manufacturer and place the contract on a General Services Administration Web site. The new provisions also expand the coverage of the Berry Amendment by requiring that components of textiles and apparel are also made in the US. In addition, the bill contains a provision (Section 832) mandating training programmes for DoD personnel about the Berry Amendment. Taken together, these provisions will hamper DoD's flexibility in applying the Berry Amendment by opening DoD waiver decisions to continuous challenge by the US textile industry.

Further DoD procurement restrictions are based on the *National Security Act of 1947* and the *Defense Production Act of 1950*, which grant authority to impose restrictions on foreign supplies in order to preserve the domestic mobilisation base and the overall preparedness posture of the US. At the same time, defence procurement from foreign companies is sometimes also impeded by Buy America restrictions on federally-funded programmes.

Memoranda of Understanding undermined

There has been a trend towards making DoD's other domestic preferences, apart from the BAA preferences, less restrictive by expanding the preference to qualifying countries. These are countries that maintain reciprocal memoranda of understanding (MoU) with the US. In practice, all *North Atlantic Treaty Organisation* (NATO) countries (except Iceland), all major non-NATO allies of the US (e.g. Australia, New Zealand) as well as Sweden, Finland and Austria have signed MoUs with the US allowing for a waiver of the corresponding restrictions.

However, these MoUs are subject to US laws and regulations, and consequently, other overriding *ad hoc* restrictions can be imposed annually by Congress through the authorisation/appropriations process (on which, see above). For example, US legislation allows the Administration (DoD and USTR) to rescind a waiver if it determines that a particular ally discriminates against US products. Similarly, the *National Defense Authorization Act for Fiscal Year 2005* requires the Secretary of Defense to "make every effort to ensure that the policies and practices of the Department of Defense reflect the goal of establishing an equitable trading relationship between the United States and its foreign defence trade partners, including encouraging ensuring that United States firms and United States employment in the defence sector are not disadvantaged by unilateral procurement practices by foreign governments, such as the imposition of offset agreements." To this effect, the Defense Secretary will also be required to develop a strategy as well as review and modify existing MoUs etc. with foreign defence trade partners. Furthermore, it is especially regrettable that Congress, after having adopted the *Fastener Quality Act of 2000*, continues to impose Buy American procurement restrictions on anchor and mooring chains. There are also indications that US procurement officers disregard the exemption of Buy American restrictions for MoU countries (e.g. fuel-cells, ball and roller bearings, and steel forging items).

The barriers to defence trade with the US result from a complex set of rules and practices aiming at imposing "domestic source restrictions" on US defence acquisition. A partial identification of all these barriers is provided in a July 1998 report of the US General Accounting Office that was established to justify these "domestic source restrictions". The following examples illustrate the large variety of obstacles facing EU exporters to the US:

- Specific requirements to produce goods on US soil. This can take many forms, for example as part of the DoD programme approval procedure, a requirement exists that any major defence item must be produced on US soil, so that EU companies can only do business by selling the licences to manufacture (e.g. Harrier Vertical Take-Off and Landing Jet). In relation to large calibre cannons, there is legislation in Congress requiring that they be produced in a particular US plant.

- There is no grant-back given for changes made to products by the licensee (a common element of licensing systems in the area of non-defence goods, as the original owner then benefits from changes made).

- Foreign comparative tests (FCT) are carried out to assess the best product for goods not produced in the US. Funds to carry out such tests were reduced in 1999, although the defence budget itself was increased. Also, experience shows that, where an FCT pinpoints a successful product, DoD seeks a licence to make that product in the US rather than entering into a direct supply contract with the offshore producer. The effect of this practice is that EU suppliers look for a US production partner early in the process.

- Barriers arising from the use of the *Foreign Military Sales Regulation* (FMSR). The FMSR introduces maximum foreign content threshold requirements for products exported with FMS support. This means that US prime contractors willing to seek FMS support are reluctant to design foreign content into their products. Instead, they prefer replacing any foreign content by US production under licence (e.g. armoured vehicles were obtained under licence from Austria and then sold on to Kuwait through the FMS system – this took sales to third countries away from European companies).

- Technical data / Technology export control requirements. Non-nationals cannot take their own foreign companies' technical data out of the US (even if only for showing around for sales purposes) unless the US company is granted a licence to export that data – and consequent rights over the data.

- US subsidiaries. One way of circumventing the US-soil production requirements is to set up a subsidiary in the US. However, such subsidiaries need to obtain both security clearance and authorisation to operate. A precondition for obtaining this is that the overseas parent company must relinquish management control of the subsidiary (US Security Manual). These "Chinese walls" are quite systematically established.

- Lack of access to bidder conferences/security clearance considerations. Foreign nationals rarely have access to bidder conferences and other pre-contract award procedures, because they are not granted the required security clearances at that stage of the procurement process.

Other restrictions based on national security

Management and operation of research and development (R&D) facilities under the Department of Energy, National Aeronautics and Space Administration (NASA), the National Science Foundation, or the DoD are often entrusted to private companies and universities under "management and operating (M&O) contracts". These contracts do not follow the open competition procedures required under the Federal Acquisitions Regulations. Very few M&O contracts have been subject to competitive procedures and often the procurements done by these companies themselves impose Buy America requirements. The US has excluded M&O contracts from its offer in the GPA. Moreover, the government has instituted a number of R&D programmes in recent years in which there is a strong preference for US participants. Examples are the Renewable Energy Export Technology Transfer Program and the High Speed Ground Transportation Development Program. Most of these programmes also require BAA compliance with respect to all materials furnished pursuant to the project.

There are numerous other marginal expenditures. While not exhaustive, the following examples of Buy America statutory programmes should be mentioned: the Balance of Payments Program; the *Merchant Marine Act of 1936*; the *Hazardous Materials Transportation Authorisation Act of 1994*; the *Amtrak Authorisation Act*; Grants for Construction of Water Treatment Works; *National and Community Service Act*; *National Science Foundation Act of 1988* (as amended); and the President's *National Space Policy Directive of 1990 and 1994*. The latter precludes US Government agencies from using foreign launch services (except, in the case of NASA, in collaborative projects not involving an exchange of funds). This policy was subject to undefined exceptions – a possibility that was never, or almost never, used.

The *Commercial Space Act of 1998* on the one hand, calls on Federal agencies to buy space launch services rather than launch vehicles. On the other hand, it requires these services to be procured from "US commercial providers", subject to certain exemptions and exceptions, for instance for international collaborative efforts related to science and technology. The Act thus legislates the Buy American policy contained until then in the President's National Space Policy but allows NASA to enter into collaborative projects with foreign space agencies even if they involve the disbursement of funds. It remains to be seen whether US Government agencies will use that possibility and, more generally, how they will interpret the notion of "US commercial provider". The US justified these restrictions, which initially applied to the launching of military satellites, on national security grounds, but they are now also applied to satellites for civilian use. These measures are part of a set of co-ordinated actions to strengthen the US launch industry and are clearly detrimental to European launch service providers. European launch operators remain in any case effectively barred from competing for most US government launch contracts, which account for approximately 50% of the US satellite market.

The US Space Transportation Policy of 6 January 2005 consolidates the Commercial Space Act in the US government's procurement of launch services from US providers only. The same situation exists for the providers of remote sensing capabilities. The US Commercial Remote Sensing Policy of 25 April 2003 directs the US government to rely to the maximum practical extent on US commercial remote sensing capabilities, not only for military and homeland security but also for civil uses. It is a stated goal of this Policy to enable US industry to compete successfully as a provider of remote sensing space capabilities for foreign governments and foreign commercial users.

Finally, it must also be noted that, among the security measures adopted in the aftermath of 11 September, *Section 108 of the Aviation and Transportation Security Act*, passed in October 2001 requires any private security firm retained for the provision of airport security services to be owned and controlled by a citizen of the US to the extent that the President determines that there are firms owned and controlled by such citizens.

Sub-federal selective purchasing laws

At the sub-federal level, selective purchasing laws (whereby the access of companies to contracts is severely or completely curtailed as a result of the companies' business links with particular third countries) continue to cause great concern. Such laws were adopted by the Commonwealth of Massachusetts (in the case of Myanmar) and more than 20 cities and local authorities. The US Supreme Court found the Massachusetts legislation unconstitutional on the grounds of division of powers between States and the federal authorities. Whilst this removes this particular obstacle, the wider issue of principle vis-à-vis the EU is left unaddressed. A similar initiative by the State of New York was dropped in September 2001.

The EU strongly objects to these attempts to regulate the behaviour of EU companies that are acting in full compliance with EU and Member States' laws. The European Commission will continue to monitor the situation in other sub-federal jurisdictions.

State Buy American legislation and restrictions

Buy American or "buy local" legislation is also rife at State level. More than half of all US States and a large number of localities do apply some "buy local" restrictions in one form or another. In some cases, the procurement of particular products is subject to such restrictions, such as steel, coal, printing and cars. Affirmative action schemes favouring small business or particular types of business (e.g. minority-owned) are also applied extensively in a large number of States. Although 39 of the 50 States are covered by the GPA of 1994, there are still gaps in its scope and, in some cases, concerns about its actual degree of implementation. Among the 11 States that have not been bound in the US GPA offer, some maintain very substantial local preferences, which have a negative impact on EU and other foreign suppliers. This is the case of Alaska, New Mexico, South Carolina and, to a lesser extent, Ohio and Virginia. In the case of New Jersey, State legislation also provides that for the construction of public works projects financed by State funds, the materials used (e.g. cement) must be of domestic origin. Even in the GPA-bound States various exemptions (i.e. for purchases of cars, coal, printing and steel and for set aside) seriously limit the procurement opportunities open to foreigners. Besides, procurements by States and localities that benefit from particular types of federal funding (e.g. in mass transit and highway projects) are subject to BAA.

Although the BAA applies in principle to the procurement of goods, it has also inspired similar provisions in the procurement of services. In March 2002 the State of New Jersey introduced new legislation for procurement of services specifying that only citizens of the US and persons authorised to work in the US pursuant to federal law may be employed in the performance of services under the contract or any subcontract awarded under the contract. This measure mainly affects computer services suppliers and suppliers with "call centres" outside the US. Although the State of New Jersey is not covered by the US commitments under the GPA, the measure risks creating a contagious effect. Other States are understood to be considering similar bills.

Set-aside for small businesses at Federal and State level

The US Federal government actively seeks to promote the growth of small businesses in numerous ways. It provides loans and grants, develops programmes to encourage bids from small business, and sets aside certain procurement contracts for small business. The "set-asides" are specifically exempted from application of the GPA. Small business set-asides account for tens of billions in expenditures or around 30% of all federal procurement dollars. It is however difficult to quantify the actual impact of these set-asides on US procurement.

The relevant legislation is the *Small Business Act of 1953*, as amended, which requires executive agencies to place a 'fair proportion' of their purchases with small businesses. The notion of 'fair proportion' means that the government-wide goal for participation by small businesses shall be established at no less than 20% of the total value of all prime contract awards for each fiscal year. Under bid procedures for civilian projects, there is a 12% preference for small businesses in bid evaluation for civilian agencies (instead of the standard 6%).

This is achieved through two different types of set-aside schemes: one, where US Federal government contracts are set-aside, regardless of the size of the contractor, in the event that there is a reasonable expectation of bids from two or more eligible US small or minority businesses; the other, where all contracts below a certain threshold (currently $2,500 to $100,000) are set aside for US small or minority businesses -contracts are only released for competitive bidding in the event that two or more eligible bidders cannot be identified. In this context, small businesses are defined as businesses located in the US that make a significant contribution to the domestic economy (through payment of taxes and/or use of US products, materials, and/or labour) and are not dominant. The standard size criterion for eligibility as a small business for goods-producing industries is 500 employees or fewer. However, for some industries (i.e. pulp, paper boxes, packaging; glass containers; transformers, switchgear and apparatus; relays and industrial controls; miscellaneous communications equipment; search, detection, navigation guidance systems and instruments) the employee limit is 750 and for some others (i.e. chemicals and allied products; tyres and inner tubes; flat glass; gypsum products; steel and steel products; computers, computer storage devices, terminals; motors and generators; telephone and telegraph apparatus) it is 1000 or even 1500 in the telecommunication sector. For services industries, depending on the sector, firms with total annual revenues of less than $2.5 million to $17 million are considered to be small businesses.

An important number of States also operate particularly proactive small businesses and minority set-aside policies. It is estimated that in States like Texas such policies effectively exclude foreign firms from around 20% of procurement opportunities. In Kentucky, as much as 70% of procurement opportunities are set aside for small businesses. The active promotion of small businesses is a common concern for the EU and the US. The EU is, however, concerned that the US "set-aside" measures and their exemption from the GPA favour US industry and have exclusionary effects to the detriment of foreign competitors.

Indirect barriers

Apart from direct legal barriers, the complexity of procurement rules and opportunities can act as an effective indirect barrier. One such indirect barrier was highlighted earlier with reference to the implementation of waivers from BAA restrictions.

Another practical limitation lies in the lack of transparency and information relating to sub federal procurement opportunities. Unlike the EU where all tender notices for central and sub central procurements are published on a single electronic site free of charge (the TED data base), only US federal notices are published on a single electronic site (FedBizOpps.gov). This situation effectively hinders foreign suppliers' (EU and others) access to sub-federal procurement markets as potential bidders do not know where to look for relevant procurement opportunities and/or information relating to sub federal purchases.

Sectoral Issues

Bearings

Congress has imposed a Buy American requirement on the procurement of ball and roller bearings since 1988, most recently until the end of 2005. In May 1996, the Federation of European Bearings Manufacturers' Association (FEBMA) made a submission to the DoD, in opposition to the restriction. The *National Defense Authorization Act of Fiscal Year 1997* contains *the "McCain Amendment*" authorising the DoD to waive Buy America requirements that would impede the reciprocal procurement of defence items under the MoU. In September 2005, the DoD issued a final rule amending the *DFARS* to authorise the Defense Logistics Agency Component Acquisition Executive to waive domestic source requirements on the acquisition of ball and roller bearings, when adequate domestic supplies are not available to meet DoD requirements on a timely basis, and provided that such acquisition is made in order to acquire capability for national security purposes. The EU will monitor the implementation of this waiver authorisation.

Iron, Steel and Non-Ferrous Metals

The main problem for the steel sector is the imposition of local content requirements or the preference given in works and other government procurement contracts for bids that include locally produced steel. This practice is notably common at the sub-federal level. Many States (such as Connecticut, Louisiana, Maine, Michigan, Illinois, Maryland, New York, Pennsylvania, Rhode Island and West Virginia) have such requirements that also apply to private contractors and subcontractors. West Virginia and Ohio have adopted legislation that introduces procurement restrictions on steel imports.

Electrical and Electronic Equipment

The conditions and procedures applied by many States, cities and utilities to procure electrical and electronic equipment favour local suppliers and local content. These restrictions discriminate against suppliers and products from both elsewhere in the US and from abroad. At the federal level, the Department of Defense, and to a lesser degree other departments, also handle procurement rules that discriminate against foreign supplies. All in all, public procurement of electrical and electronic equipment in the US does not abide by the principle of most favoured nation in respect to countries to which the US has granted that treatment.

US food aid purchases

Under US regulations, only US commodities may be used in food aid transactions. Legislation expressly includes among its food aid objectives opening up markets for US exports (PL-480) and provision for "overseas donations of surplus commodities acquired by the Commodity Credit Corporation" (Section 416-b). The provision of such non-genuine food aid causes significant losses to commercial supplies of commodities. Several EU markets have been targeted by non-genuine US food campaigns.

Regarding transportation of US food aid, the US imposes cargo preferences on the World Food Program (WFP) requiring that at least 75% of tonnage granted is transported on vessels carrying the US flag. It is, however, recognised that freight rates on ships carrying the US flag are generally higher than those of other ships. The cost difference between the estimated amount of freight on a ship not carrying a US flag and the actual freight on a US vessel is called the Cargo Preference Premium. From 2002, income and expenditures are being recorded on the basis of the adjusted global freight estimates (net of cargo preference premiums). However, as a service to the US, the WFP continues to account for cash receipts and cash disbursements related to US cargo preference premiums thus adding important operational costs. The EU considers this is a way of extending restrictive and discriminatory public procurement practices beyond the US public procurement market. In fact, this policy imposes Buy American requirements on a UN organisation.

Telecom equipment

In 1993, the US imposed sanctions against the EU and certain Member States under *Title VII of the Omnibus Trade and Competitiveness Act of 1988* concerning the purchasing of telecom equipment. The sanctions bar EU suppliers from bidding, *inter alia*, for US Federal government contracts that are below the threshold values of the GPA. The EU responded with counter-sanctions (Regulation 1461/93) that also bar US bidders from applying for contracts awarded by central government agencies below the threshold values.

Following the liberalisation of the EU telecom sector and the entry into force of new procurement rules in 2004, the whole telecom sector is now excluded from the scope of EU Directives on public procurement. Therefore, the EU proposed to mutually remove the existing sanctions. The US has so far not taken up this proposal. Anticipating an eventual solution, the European Commission adopted in January 2002 a proposal for a Council Regulation repealing the EC counter-sanctions. This Regulation will however only be adopted by the Council once the US lift their sanctions.

5.8 Trade Defence Instruments

In recent years, the use of US trade defence measures have increased substantially. Their misuse has been repeatedly denounced by the EU, other WTO Members, and the WTO itself.

This has been reflected in the increasing number of cases brought to the WTO Dispute Settlement system in relation to US trade defence legislation and proceedings. Several aspects of US trade defence legislation and practices have already been condemned for their inconsistency with WTO Agreements (e.g. the 1916 US Antidumping Act, the methodology used by the US DoC in privatisation cases, and the “Byrd Amendment”.) Implementation of WTO findings has, at best, been slow.

US Antidumping Measures

Different aspects of the US legislation and practice on antidumping investigations have also been challenged, notably the so-called "Byrd Amendment", the use of zeroing in the determination of the dumping margin and, lately, the misuse of Best Information Available.

Byrd Amendment

The *Continued Dumping and Subsidy Offset Act* (CDSOA or the so-called “Byrd Amendment”), signed into law in October 2000, provides that proceeds from anti-dumping and countervailing duties shall be paid to the US companies responsible for bringing the cases. This is clearly incompatible with several WTO provisions. The enactment of this legislation raised immediate and widespread concerns not only in the EU but in the whole WTO membership. The EU and 10 other WTO members (Australia, Brazil, Chile, India, Indonesia, Japan, Korea, and Thailand – later joined by Canada and Mexico) brought a complaint to the WTO dispute settlement system and their claims were supported by 5 other

WTO Members acting as third-parties. This unprecedented joint action is a clear indication of the important systemic concerns that the legislation raises.

The Panel in September 2002 and the Appellate Body in January 2003 confirmed that the Act was an impermissible response to dumping and subsidisation, thus upholding the core of the complainants' claims. The Panel even took the unusual step to recommend the repeal of the Act.

The United States had until 27 December 2003 to comply with the WTO ruling, but failed to do so.

In light of the above, the EU and seven other complainants (Brazil, Canada, Chile, India, Japan, Korea, and Mexico) requested the authorisation to suspend the application to the US of concessions or other obligations to preserve their rights after the expiry of the implementation deadline. Following arbitration on the authorised level of suspension, the 8 members obtained the authorisation to suspend the application of concessions or other obligations to the US in accordance with the arbitration award (on 24 November 2004 for Brazil, Canada, the EU, India, Japan, Korea and Mexico; on 17 December for Chile).

The EU started the application of retaliatory measures on 1 May 2005 in the form of a 15% additional import duty on a range of US products including paper and textile products, machinery and sweet corn. In accordance with the arbitration award, the level of retaliation will be revised annually and new products may then become subject to retaliation. Three other WTO members have also started to apply retaliation: (1) Canada also from 1 May 2005 (a 15% additional import duty on live swine, tobacco, oysters, specialty fish); (2) Mexico from 18 August 2005 (additional duties of 30% on dairy products, 20% on wine and 9% on candy and chewing gum); and (3) Japan from 1 September 2005 (a 15% additional import duty on ball bearings, different steel products, printing machines, fork lift trucks). The other complainants may apply retaliation at any time they deem appropriate as all required steps in the WTO have now been completed.

On 25 July 2005, the House Ways and Means' Trade Subcommittee Chairman called interested parties to comment on the possible inclusion of a repealing bill into a miscellaneous trade bill. On 26 October 2005, the Ways and Means Committee took a first encouraging step by passing legislation to permanently repeal the CDSOA. On 18 November, the House passed legislation (H.R. 4241, the Deficit Reduction Act of 2005) that included a provision to permanently repeal the CDSOA. However, the Senate did not include such repeal in its version of the same legislation. A House-Senate conference committee agreed a compromise version that would repeal the CDSOA effective 1 October 2007. While the CDSOA would be permanently repealed, US companies would be able to receive Byrd distributions until years past the two-year transition because any customs entry subject to an existing AD/CVD order prior to that date, regardless of when it is liquidated, could be distributed. The House passed this compromise version on 19 December; the Senate followed suit on 21 December. However, for procedural reasons, the House must re-pass the Deficit Reduction Act of 2005 a second time, which it is expected to do in early February 2006, before the bill can become law.

Since the enactment of the CDSOA, the US authorities have distributed to domestic petitioners more than $1.2 billion and a new round of distribution started on 1 October 2005. Further, a very limited number of recipients received a major part of the payments. Of the total disbursed so far, 40% went to one company and its subsidiaries and two thirds to three industries (bearings, candles and steel). Every year half of the payments went to a very limited number of companies (4 in 2001, 3 in 2002, 2 in 2003, 9 in 2004 and 4 in 2005).

This concentration of the CDSOA benefits into the hands of a few companies was one of several flaws underlined in a critical report released by the *General Accountability Office* (GAO) on 26 September 2005. The GAO also stressed the substantial overstatement of the eligible claims since their accuracy is, in practice, not verified or the distortion of competition generated by the Act, including at the expense of US producers who cannot receive any payments for not having supported the investigation at the origin of the anti-dumping or anti-subsidy measure.

<u>Use of zeroing in the determination of dumping margin</u>

In original investigations, (i.e. investigations that lead to the imposition of the anti-dumping duty), the US Department of Commerce (DoC) continues to use a dumping margin methodology that was condemned in the Bed linen (March 2001) and softwood lumber (August 2004) cases. This methodology consists in disregarding negative dumping margins established for certain models of the product concerned (put at zero) when calculating the overall margin for the product. Although both disputes were concerned with specific anti-dumping measures (EU measure in the bed linen case, US measure in the softwood lumber case), they unambiguously invalidated the “zeroing” methodology as such when used in well-defined circumstances. But the US refuses to abandon its methodology. In respect of the Bed linen decisions, the US argued that they have effect *inter partes* only. In softwood lumber, the US adopted a minimalist approach. It maintained its method of calculation and only re-calculated the rate of the duty on softwood lumber even continuing zeroing in that specific case on the pretext of using a different calculation method not covered by the WTO ruling.

In reviews (i.e. subsequent investigations that may be pursued to re-determine the level of the duty or to review the necessity to maintain it), DoC systematically uses a calculation methodology, which also includes "zeroing" in circumstances not contemplated by the WTO AD Agreement.

The US “zeroing” practice is having a significant adverse economic impact on EU exporters in various sectors including steel, chemicals and pasta. Several hundred million dollars of trade volume is involved. Some of the products (hot-rolled steel, stainless bar, ball bearings) are major export items and other important products will inevitably be involved in the future if the US is allowed to continue “zeroing”.

WTO consultations were requested on 12 June 2003 on the law, the implementing regulation, the DoC methodologies and 21 specific cases (new investigations and annual reviews of the duty or administrative reviews). An additional request for consultation was made on 8 September 2003 on 10 specific cases. In most instances, without “zeroing”, the dumping margin would have been *de minimis* or even negative and, therefore, no anti-dumping duty would have been imposed or collected.

The consultation has failed to solve the issue and following a request by the EU on 5 February 2004, the Panel was established on 19 March 2004 and its report was issued on 31 October 2005. The Panel has concluded that the United States breaches its WTO obligations not only by using zeroing in specific investigations but also by using a zeroing methodology in original investigations. However, two of the three panellists (whose views then prevail) concluded that Members are free to apply zeroing in reviews. This creates a serious imbalance of rights and obligations between WTO Members by opening a way out of the prohibition of zeroing for Members which, as the United States, apply a retrospective system of collection of duties. In such systems, the margin established in the original investigation will indeed rarely determine the amount of anti-dumping duties to pay. In most cases, the final liability is determined by the margin calculated in reviews and which could then be duly inflated by the use of zeroing. By contrast, in prospective systems such as the EU’s system, the duties to be paid are determined by the rate established during the original investigations in which the prohibition of zeroing fully applies. The EU intends to appeal the panel report.

Misuse of best information available – the Firth Rixson case

In March 2002, the DoC imposed an anti-dumping duty of 125.77% on imports of stainless steel bars from the United Kingdom made by Firth Rixson Special Steels Limited (FRSS). This very high duty rate is the direct result of DoC's rejection of the data provided by FRSS during the investigation. DoC then did not conduct a verification visit and established a duty on the basis of adverse facts available, i.e. the margin of dumping alleged by the complainant. To justify this reatment, the DoC alleged that FRSS had failed to comply to the best of their ability with DoC's requests for information.

DoC's rejection of FRSS' data was motivated by FRSS' alleged failure to provide detailed cost data for a small number of sales made by a factory which it had acquired in a merger and had then closed and dismantled long before the investigation was started. Not knowing there would be an anti-dumping case, the company did not keep detailed costing data, since this was not legally required. The DoC, without checking the facts or conducting an on-site visit, simply chose not to believe FRSS. For the vast majority of its US sales, i.e. other than those made from the factory in question, FRSS cooperated fully to the satisfaction of the DoC.

FRSS has tried and failed to obtain relief in the US Court of International Trade. In this regard, the US law on the application of "adverse facts available" which gives to DoC a very wide margin of discretion is of some concern. In addition, it is clear that the DoC has breached the WTO Anti-Dumping Agreement (notably the provisions of Article 6 and Annex II thereof) by applying adverse facts available in this case. The anti-dumping duty imposed bears no relationship to any margin of dumping found for any exporter during the proceeding. Furthermore, this is not a one-off problem, since the misuse of "facts available" has been a feature of US dumping cases for many years.

Given the egregious nature of the case in question, and the recurring aspect of the problem, the EU decided to request consultations with the US on 5 November 2004. Two rounds of consultations have been held in 2005 and possible solutions to this dispute are still being explored.

US Sunset Reviews of Antidumping and Countervailing Duty Measures

The Uruguay Round negotiations introduced in the Antidumping and Subsidy and Countervailing Measures agreements the obligation to terminate the measures after five years unless the authorities determine in a review ("sunset review") that termination of the measures would likely lead to the continuation or recurrence of dumping and injury. The objective of introducing sunset reviews provision was to avoid never-ending measures. It is the EU understanding that the substantive disciplines governing the imposition of the duty should apply, albeit with some modifications, to the prolongation of the duty for another five years. The US conduct of sunset reviews falls short of these requirements. For example, the US imposes unwarranted conditions on the participation of exporters in sunset reviews, requiring respondents to cover 50% of exports before it will conduct a "full" sunset review.

The US, due to this "minimalist" interpretation of the SCM Agreement, has kept in place many CVD orders dating back as far as 1985, although the subsidies involved have usually expired, ceased to exist or confer only minimal benefits. The EU brought the US sunset review practice to dispute settlement in 2001 in the DS213 *Carbon Steel from Germany*. Although the challenge was not immediately successful (the Appellate Body confirmed that

DoC could self-initiate sunset reviews and use a 0.5% *de-minimis*), it did lead indirectly to the revocation of the measure in question, and some of the statements of the Appellate Body on the obligations of the US in sunsets were helpful.[5]

The EU is currently pursuing this issue in a large number of pending sunset reviews. In June 2004, the EU obtained, for the first time, in the case of *Stainless Steel Wire Rod from Italy*, the revocation of a CVD measure by DoC. However, in the case of *Stainless Steel Plate in Coils from* Italy, for which the final DoC findings were issued on 3 March 2005, the DoC determined that the measure should continue after finding a subsidy of 0.73%, but only by including a subsidy (Italian law 451/94 – payments to redundant workers) for which the benefits have now been largely amortised and will completely disappear in 2006/7. Without this, the rate would have been well below the 0.5% *de minimis* threshold of the US legislation and the measure would have been terminated. The DoC took the same approach in *Stainless Steel Sheet and Strip from Italy*, involving the same exporter, AST, when it made its final finding in early May 2005. The *International Trade Commission* (ITC), in decisions of 7 and 21 June 2005 respectively, made positive injury findings and so the measures are extended for another five years. The EU will now have to consider what further action to take. This issue of the continuation of virtually amortised measures is of some concern and has been raised in the current WTO Doha Round talks.

A further sunset review on CVD measures against Brass Sheet and Strip from France, a measure which goes back to 1987, started on 1 April 2005. Again, the issue is one of the expiry of amortised subsidies. The preliminary finding in October 2005 indicates that the level of subsidy is now *de minimis.*

US Countervailing Duty Measures against privatised firms

Still with regard to sunset reviews, the EU also challenged the methodology used by the US to apply countervailing duty legislation to privatised companies. In June 1998, the EU initiated a WTO dispute settlement procedure against the DoC countervailing methodology with respect to privatisation of the EU company, British Steel. The European Commission held that the US practice of countervailing pre-privatisation subsidies without showing whether the privatised company has obtained a benefit constitutes a violation of the WTO *Agreement on Subsidies and Countervailing Measures* (ASCM). The Panel finally established to examine the issue found, on 23 December 1999, in favour of the EU and condemned the US methodology. The WTO Appellate Body confirmed these findings on 10 May 2000.

The US has taken the view that the ruling only applies to the British Steel case, and has no impact on the 14 other DoC measures against privatised EU firms (almost all in the steel sector). The change of ownership methodology has also come under some domestic pressure, following the loss of the *Delverde* case in the US Federal Court of Appeals.

On 13 November 2000, the EU requested consultations with the US under the DSU on 12 outstanding cases. While the US admitted that the methodology used in the British Steel case was not in compliance with WTO rules, it replaced it with a methodology that appears to be equally contrary to WTO rules and produces even worse results for the exporting companies.

In these circumstances, the EU requested consultations also on the new methodology and a last attempt was made with the new US Administration in order to find an acceptable solution without having to resort to WTO Panels, but to no avail. On 18 July 2001, the DoC confirmed

[5] Other WTO panels e.g. *Corrosion-Resistant Steel – Japan* and *OCTG – Argentina* have also covered this issue.

that it would not accept the compromise proposals made by the EU. Therefore no alternative was left but to pursue the matter before the WTO.

The Panel was established at a special DSB meeting on 10 September 2001. The EU won this case as well. The Panel report circulated on 31 July 2002 indicated that the WTO incompatibility of the US methodologies was due to the fact that the US failed to determine whether the new privatised producer received any benefit from prior financial contributions to state-owned producers. The US appealed the Panel's report and, on 9 December 2002, the Appellate Body upheld the incompatibility of the US measures and practice, while "saving" its legislation. The Appellate Body report was adopted on 8 January 2003. The EU and the US agreed under Article 21.3(b) DSU that the reasonable period of time for the US to comply should lapse on 8 November 2003.

The US notified their compliance at the DSB meeting on 7 November 2003. The US introduced a methodology that, if correctly applied, would appear to be consistent with the ruling of the Appellate Body. Unfortunately, the DoC did not consider it necessary to make use of this methodology as regards four (then reduced to three because one case was settled with the US industry) of the twelve cases at issue, all involving sunset reviews (steel products from France, UK and Spain).

These aspects of the US implementation remain unsatisfactory and may have significant impact on future cases involving privatisations in new EU Member States. For these reasons and after consultations with the US did not result in any progress, the EU finally requested a compliance Panel under DSU Article 21.5. The Panel was established on 27 September 2004 and the final report was issued in August 2005 and adopted in September 2005. The report faulted the US for not having examined the privatisations in the UK and Spanish cases; the US will now have to implement this finding. In addition, all three measures are due for a second sunset review, which was started in November 2005.

Anti-dumping/CVD Uranium

In March 2002, the US imposed a countervailing duty on imports of low-enriched uranium from France, Germany, Netherlands and UK, and an anti-dumping duty on France. The countervailing duty for Urenco was only just over 2% (now *de-minimis*) but the combined duty for France was over 30% (since reduced substantially in the first two reviews). In a decision of 3 March 2005, further confirmed by a decision of 9 September 2005, the US Court of Appeals of the Federal Circuit ruled that the enrichment was a service, not a good as the DoC had found, and therefore could not be subject to anti-dumping or countervailing measures. In two remand orders dated 5 January 2006, the US Court of International Trade directed the DoC to revise its final antidumping duty determination and order its final countervailing duty determination order, in accordance with the two decisions of the US Court of Appeals fo the Federal Circuit. This finding was confirmed in September 2005. In the absence of a challenge in the Supreme Court, these measures will probably have to be revoked in 2006.

5.9 Export Restrictions

Export controls

A comprehensive system of export controls for dual-use items was established under the *Export Administration Act* (EAA) of 1979 and the US Export Administration Regulations (EAR) to prevent trade to unauthorised destinations. This system, among other things, requires companies incorporated and operating in the EU to comply with US re-export controls, including compliance with US prohibitions on re-exports for reasons of national security and foreign policy. At present, the US export-control system for dual-use items listed on the US Commerce Control List (CCL) dictates that foreign companies require re-export licenses for items containing 25% or more of US-origin content. When such items are re-exported to countries listed on the US State Department's list of "countries supporting terrorism," the requirement is stricter and all items with 10% or more of US-origin content listed on the CCL require re-export licenses. In some cases these re-export authorisations infringe on the European Single Market. The extraterritorial nature of these controls has repeatedly been criticised by the EU, given the fact that it consists of active members of all international export control regimes: the Nuclear Suppliers Group, the Australia Group, the Missile Technology Control Regime and the Wassenaar Arrangement (see Iran Non-Proliferation Act, Section 3.1).

Furthermore, on 12 December 2003, the President Bush signed into law the *Syria Accountability and Lebanese Sovereignty Restoration Act of 2003* (SAA). The President has chosen to implement a SAA provision prohibiting exports of items listed on the Commerce Control List. This dual-use ban provision also constitutes a *de facto* prohibition on re-exports by EU companies, as US export control regulations require a new licence every time an item with at least 10% US-origin content is re-exported from a foreign country to a country "supporting terrorism" (i.e. Syria). Now that there is a general ban on exports and re-exports to Syria, such re-export licenses would not be given and this *de facto* prohibition on re-exports for reasons of US national security and foreign policy would negatively affect EU exports to Syria containing US components.

Deemed exports are barriers which in some cases affect the functioning of EU-funded research projects with third countries where the US participates. The need to get authorisation prior to exchanging a small content of US-controlled technology with third countries' residents in the EU must be agreed in advance by the Department of Defense on a case-by-case basis

In March 2005, the US Department of Commerce's Bureau of Industry and Security (BIS) issued a Federal Register notice soliciting comments from the public on how revisions suggested by the Commerce's Office of the Inspector General regarding deemed export controls would affect industry, the academic community, and US government agencies involved in research. The regulatory changes proposed by BIS include an amendment of BIS's policy to require US organisations to apply for a deemed export license for employees or visitors who are foreign nationals and have access to dual-use controlled technology if born in a country where the technology transfer in question would require an export license, regardless of their most recent citizenship or permanent residency. US industry strongly opposed this rule, according to which decisions to grant deemed export licenses would be based on the country of birth or prior residence of the foreign national in question.

In an op-ed published in the *Financial Times* on 13 December 2005, United States Under Secretary of Commerce David McCormick announced that: "The Commerce Department will soon publish a policy, basing controls on access to sensitive technology on a foreign national's most recent country of citizenship or permanent residency, not country of birth". The EU is concerned that the Commerce Department's plans as set out an this article are discriminatory and would be almost impossible to implement on a daily basis as every person would have to be checked in advance and prove his/her most recent citizenship/residence prior to being authorised to cooperate on a given industrial project where some dual use technologies would be concerned. This would risk negatively affecting EU-US cooperation when EU residents by mistake happened to have been born in some of those countries of concern. The EU reiterates that its policy is of free circulation of dual use goods within the EU because of the single market with the exception of a few items listed in Annex IV of the Regulation 1504/2004 in force and that this policy applies equally to transfers which are tangible and intangible.

Following a conference between the European Commission and EU dual use exporters in 2004, it became clear that US re-export clauses which affect EU companies exporting dual use items with some US content (in some cases as little as 10% of controlled technologies) and even in some cases, concern non US origin technologies exported by EU citizens to countries under US unilateral embargo. This is creating barriers to market access in third countries to EU companies. They are not in line with the EU policy of dual use exports to those countries which deny some dual use exports based on Common Foreign and Security Policy grounds and do not apply "total embargoes" to those countries.

Serious concerns have also been raised by the *1988 US Trade Act's amendment to Section II* of the EAA providing for sanctions against foreign companies which have violated their own countries' national export controls, if such violations are determined by the President to have had a detrimental effect on US national security. The possible sanctions, which would consist of a prohibition of contracting or procurement by US entities and the banning of imports of all products manufactured by the foreign violator, would appear to be contrary to the GPA.

Satellites

Since 1999, the jurisdiction for export controls on commercial communications satellites as well as parts and components and related technical data has been transferred by Congress (*National Defence Authorisation Act*) from the Commerce Department to the State Department. Goods or technologies previously listed as dual-use goods have been added to the US munitions list, thus subjecting them to tighter controls. Exceptions were provided by Congress calling for an expeditious treatment of export licence requests for NATO and major non-NATO allies. However in practice this exception has no effect, with the US Administration retaining wide latitude for imposing additional export control requirements, also on NATO countries, as it sees fit for reasons of national security. These additional controls, including monitoring of technical exchanges with EU firms, led to delays and uncertainties in the licensing process, causing concerns about possible delays in satellite launches and impairment of EU launch providers' ability to serve the US commercial market (US Government launches are reserved for American providers according to *the Commercial Space Act of 1998*-- see Section 5.7 on "Government Procurement"). They also impacted negatively on manufacturers of satellites and components which rely on US parts, impair the ability of EU firms to reply to US bids for tender, and affect European insurers of launches of US satellites whose access to the technical data required to assess the insurance risks has been hampered.

A provision in the *FY2000 Consolidated Appropriations Act* signed into law in November 1999 attempted to clarify the so-called "*NATO/non-NATO major allies exception*." Pursuant to this provision, a new regulatory regime for export licenses to US allies was established in May 2000, primarily for satellite components, parts, accessories and technical data, and entered into effect in July 2000. A separate regime was set up for commercial communication satellites involving US allies, including those exported to French Guyana for launch. Then US Secretary of State Albright gave assurances in a May 2000 letter to Members of Congress that the licensing process would be expedited. Industry has had to implement processes and devote resources to mitigate the impact of the US licencing regime on companies' ability to have a timely and full access to technical information from US suppliers or access to US bids. So far attempts at legislative reform of the regime controlling exports of dual use items and technologies have failed.

Encryption

Several aspects of the US encryption control policy raise concerns. Potential problems are posed by the differential treatment of encryption items depending on whether they are transferred to government and non-government end users. In addition, the generalised introduction of the technical review of encryption products above a certain key length in advance of sale creates a difficulty for the European industry for cases of re-export. The effect of the Cryptography Note, as introduced in the Wassenaar Arrangement, has been reduced by the US authorities through the introduction of two new requirements: "crypto functionality should not be modified or customised" and "the items cannot be network infrastructure products such as high end routers or switches designed for large volume communications." The latter items still need to be licensed.

A combination of the continuing constraints on the export of strong encryption products and on the interoperability of systems employing such technology inhibits not only trade in encryption products but also, more importantly, the effective growth of e-commerce. Thus, significant barriers to international trade in encryption products without key recovery continue to exist, despite the fact that EU Member States, like the US, are all members of the Wassenaar Arrangement.

The trend reported by some EU Member States of the US denying the export of certain dual-use items to EU Member States is especially worrying, given the high non-proliferation commitment of the EU Member States and the substantial initiatives they have taken in this area, in particular at the Thessaloniki European Council meeting in June 2003. At this European Council meeting, a declaration of principles and an action plan against proliferation of weapons of mass destruction was adopted which contains a number of provisions regarding the strengthening of export controls of dual-use related items in an enlarged EU.

5.10 Subsidies

Both US Federal and State authorities continue to provide significant direct and indirect support to US industry, by means of direct subsidies, protective legislation, or tax policies (see also Section 5.5 on Import Prohibitions, Section 5.6 on Sanitary and Phytosanitary Measures and Section 8.5 Transport Services). In this respect, *Foreign Sales Corporations* (FSC) legislation and its replacement, the *FSC Repeal and Extraterritorial Income Exclusion Act* (ETI), has remained for many years a matter of major concern. In addition, the adoption by the US Congress of the *Farm Security and Rural Investment Act of 2002* (2002 Farm Act), whose application has significantly increased the trade distorting effect of US farm subsidies, is of particular concern to the EU as well as to other WTO members.

Notification of US subsidies to the WTO

Transparency in the area of subsidies is an obligation of the ASCM. Up to 1998, the US only notified the WTO of a limited number of Federal programmes, many of which were relatively small, and would not notify its many State-level subsidies. However, following pressure from the EU, in the form of detailed questions and a counter-notification under Article 25.10 of the ASCM, the US finally began to notify certain State-level subsidies in its new and full notification of 1998.

This notification was reviewed in the WTO Subsidies Committee in May 1999. The EU still remained concerned by the lack of information on US State-level subsidies, particularly large, *ad hoc* investment incentives. The reporting of Federal subsidies was improved, although there were still gaps as regards certain sectors, notably aerospace. The US undertook to include non-notified subsidies, including those identified by the EU, in the next update notification. This should have been provided in 1999. However, no update was provided until the Subsidies Committee on 2 July 2002, where the US provided an update on subsidies for 1999 and 2000 and a new and full notification for 2001. In October 2003 the US presented a new and full notification for the 2002 fiscal year.

Foreign Sales Corporations

US legislation authorising so-called Foreign Sales Corporations (FSCs) (*26 USC Sections 921-27*) provided that, under specific conditions, certain income earned by a foreign subsidiary of a US corporation would not be subject to US tax. The purpose of this favourable tax treatment had been to encourage the export of US manufactured goods. The FSC was general legislation, applicable to all industrial and agricultural sectors, including the software and military sectors.

Subsidies that are contingent upon export performance or upon the use of domestic over imported goods are strictly prohibited under the WTO. The FSC scheme applied exclusively to the export of goods and these goods had to have more than 50% of their market value of US origin. Therefore, the FSC scheme provided a prohibited subsidy within the meaning of Article 3 of the ASCM and Article 1 of the Agreement on Agriculture.

Contrary to US claims, FSC tax exemptions cannot be justified by the aim to avoid double-taxation for US companies established abroad, as FSCs were typically established in tax havens where no income tax is paid at all. For instance, in 1996, 91% of all FSCs were incorporated in the US Virgin Islands, Guam and Barbados.

On 24 February 2000, the WTO Appellate Body confirmed the ruling of a Panel which was ruled in favour of the EU, as it considered that FSC exemptions amount to a prohibited export subsidy under the ASCM as well as the Agreement on Agriculture. The WTO gave the US until 1 October 2000 to comply with the ruling (extended to 1 November).

On 15 November 2000, the *FSC Repeal and Extraterritorial Income Exclusion Act* (ETI) came into effect. This Act provided US firms with prohibited export subsidies and so did not comply with the Panel's rulings. On 17 November, the EC challenged the ETI Act. The report of the Article 21.5 compliance Panel, circulated on 20 August 2001, confirmed that the ETI was in breach of the US WTO obligations. This Panel ruling was upheld by the Appellate Body in its ruling circulated on 14 January 2002.

On 30 August 2002, the WTO arbitrators awarded the EU $4.043 billion of potential countermeasures that could be applied if the US did not repeal the ETI scheme. On 7 May 2003, at a special meeting of the Dispute Settlement Body (DSB), the European Commission was authorised to impose countermeasures. On 5 November 2003, the European Commission adopted a proposal for a regulation imposing countermeasures as from 1 March 2004 on a number of US origin products in connection with the FSC WTO dispute. The Council unanimously approved the regulation on 8 December 2003. Countermeasures entered into force on 1 March 2004. On 22 October 2004, President Bush signed into law legislation passed by Congress foreseeing the repeal of the FSC-ETI legislation (*the American Jobs Creation Act of 2004*). The legislation repeals the FSC-ETI subsidies as from 1 January 2005 but maintains such subsidies for a transitional period expiring end 2006, as well as for a number of contracts for an indefinite period of time under the so-called grandfathering clause. Consequently, on 5 November 2004 the EC requested consultations under Article 21.5 of the DSU (compliance Panel) but at the same time signalled its willingness to suspend countermeasures.

On 31 January 2005 the Council adopted Regulation 171/2005 suspending the additional duties – the suspension was retroactive as from 1 January 2005. In the meantime, a Panel was established at the DSB meeting of 17 February 2005. The final report of the WTO Panel was released on 30 September 2005 and circulated to WTO members. The report concludes that despite some major changes to its legislation, the US has yet to fully abide by previous WTO rulings and the recommendations of the WTO Dispute Settlement Body. The Panel also makes clear that the tax subsidies which have been carried forward by using transitional periods and 'grandfathering' provisions violate WTO subsidy rules. The US appealed the ruling on 16 November and the Appellate Body report is expected in mid February 2006. The Council Regulation suspending the additional duties provides that the trade sanctions will be reintroduced on 1 January 2006 or 60 days after the adoption of the compliance panel/Appellate Body report finding the US law WTO incompatible, whichever of the two is later in time.

Among the major beneficiaries of the FSC/ETI are Boeing, Caterpillar, General Electric, Microsoft, Intel, and Motorola. By way of example, for Boeing, the major beneficiary, the value of FSC/ETI benefits for the period of 1995-2004 is estimated to be $1.625 billion (of which an estimated $1.4125 billion benefit Boeing's large civil aircraft business for the same time period).

Agriculture and Fisheries

US Agricultural Export Subsidies and Export Promotion

The US operates a range of programmes designed to subsidise and/or promote exports of US agricultural products. The US has continued to maintain an aggressive export policy for agricultural products.

The *Export Enhancement Program* (EEP) allows US exporters to apply for a cash subsidy designed to make US products competitive with exports from other countries. *The Dairy Export Incentive Program* (DEIP) is also used for dairy market development purposes. The *Market Access Program* (formerly the Market Promotion Program) offers a share of costs for promotion campaigns for agricultural products (the majority being high value and value added) in selected export markets. The total budget for market development programmes for FY2005 is $254 million.

The *Export Credit Guarantee Program* which is managed by USDA/FAS has a major impact on a number of key agricultural markets. Under this programme, the US government guarantees credits up to 98 % of the export value --on a short-term to long term basis (SCGP: up to 180 days, GSM-102: up to 3 years, GSM-103: up to 10 years). The programme includes a specific list of commodities per country allocation. It has recently become the main export policy tool of USDA, with annual allocations exceeding $5 billion and declared annual subsidy levels of over $400 million. The programme has a default rate of over 10% historically, and it is characterised by uncertainty (and lack of transparency) with respect to the implicit subsidy component stemming from the terms and conditions which are more favourable than what the private sector is offering in this area, the rescheduling of payments or bilateral debt forgiveness. Both the GSM-102 and GSM-103 are distortive insofar as the credit terms exceed the average life of the product/commodity in question, and the risk premia are inadequate to cover the long-term operating costs and losses of the programmes. Furthermore, new commitments are not only demand driven but based on a selection of buyer country and product by the US Administration.

In December 2001, the US extended a further export credit programme, the short-term *Supplier Credit Guarantee Programme* (SCGP)--up to 180 days) to exports to the EU. This programme had a budget of $1.1 billion in 2004.

US export credit guarantee programmes have recently become the object of a challenge in the WTO, in the *US – Cotton* dispute brought by Brazil. The Panel and the Appellate Body found in March 2005 that, despite Article 10.2 of the Agreement on Agriculture, export credit guarantees are not exempt from the export subsidy disciplines of that Agreement. The Panel and the Appellate Body condemned the export credit guarantee programmes at issue in this dispute (GSM 102, GSM 103 and SCGP) as prohibited under the illustrative list of the Subsidies Agreement because the premia paid by cotton exporters did not cover the expenses of the agency in charge of the programmes over the 1992-2002 period.

Following the cotton ruling, the USDA has announced some changes in the operation of GSM 103, GSM 102 and SCGP to bring them in conformity with WTO requirements. The US administration has also proposed to repeal another export programme particular to cotton, the Step 2 program, but this proposal needs to be passed into law by Congress, which has not yet taken a final view on it.

The European Commission is of the view that the changes (i.e. introduction of risk-based fees) to GSM 102, GSM 103 and SCGP introduced by the administration as a result of the *Cotton* ruling are a step in the right direction but are sufficient neither for purposes of implementation nor to eliminate all forms of subsidies flowing through the US programmes as required by the WTO Framework Agreement of August 2004. In order to match the EU conditional offer to eliminate its export refunds in the context of the current WTO negotiations on agriculture, more changes to the credit programmes will be needed (i.e. adaptation of the self-financing principle to the short-term character of the remaining credits with repayment periods of 180 days or below) In that respect, the announcement of USTR Ambassador Rob Portman of 10 October 2005 to bring them in line with commercial practices as a result of the current negotiations would seem to be encouraging

The *Facilities Guarantee Agreement* supports exports of equipment, goods and services related to the agricultural sector (up to eight years) with an annual budget of $250 million.

State-level export promotions often remain concealed and unnotified to the WTO. In 2001, Washington State paid an export subsidy to foreign purchasers of apples. This was contrary to US WTO undertakings. Following representations by the EU, the USTR agreed to discontinue the measure and committed not to launch similar programmes in the future.

Finally, the propensity of the US to use food aid to countries not suffering food shortages as a means of disposal of surplus farm products has the effect of disturbing local markets, cut out traditional supplies and undermine local producers. Following EU complaints, the US has partially reviewed its policy. However, the 2002 Farm Act has reinforced the role of US food aid as an export enhancement tool and this has been further underlined by Congress in the debate over the budget for FY06, where the Congress has opposed a proposal by the administration to allocate 25% (i.e. $300 million) of the PL 480 Title II programme for local and regional purchases of food commodities (by USAID) outside the US market. In addition, in the present WTO negotiations, the US -both Administration and Congress- are resisting strongly any attempt to strictly regulate food aid operations. In particular they oppose the principle of providing food aid “in cash” insisting that also in future all US food aid be procured on the US market (including preference for transport / handling on US logistics).

2002 US Farm Act

Agriculture policy was overhauled in 2002 with the passing of the *Farm Security and Rural Investment Act of 2002* (2002 Farm Act). Despite a consensus among WTO Member States that farm policies should be reformed in the direction of less trade-distorting forms of support, the 2002 Farm Act went in the opposite direction and increased the distortionary effect of US farm subsidies. The main elements of the new legislation were:

– increase of 80% in spending on commodity subsidies above the levels foreseen under the pre-existing policy (totalling $15-20 billion per year, depending on market prices);

– introduction of new 'counter-cyclical' payments for arable crops, designed to compensate for falls in market prices. These payments, together with the continued 'loan programme', shield farmers from low prices and thus perpetuate a cycle of over-production and downward pressure on prices;

– updating of 'base areas' on hitherto 'fixed' arable crop payments, thus re-linking these subsidies to current production;

– payment of a new 'counter-cyclical' subsidy to dairy farmers to counteract price movements;

– introduction of a 'promotional levy' on dairy imports, which could be applied in a manner to act as a tariff increase (see also Section 4.1 on “Applied Tariff Barriers”);

– new subsidies for producers of fruit and vegetables, wool, mohair, honey, and for grassland livestock farmers;

– substantial increases in export assistance measures, including a 120% increase in the Market Access Promotion programme to $200 million per year, and non-emergency 'food aid' programmes explicitly designed to expand US export opportunities and dispose of surplus production;

– subsidies for energy producers who utilise agricultural commodities, such as maize and soya.

The US’ 2002 farm policy has been widely criticised, both within and outside the US. The main reasons are (a) the potential for the crop subsidies to depress world prices; (b) the probability that the US exceeds its WTO limit of $19.1 billion production-linked support (the 'AMS limit’).

The EU monitors the implementation of the 2002 Farm Act for compliance with trade rules, and as necessary, defend its rights, notably in the framework of the WTO (notifications in accordance with the provisions of the Agreement on agriculture, trade policy review mechanism). The US has not yet notified the implementation of the new and modified support schemes to the WTO. Despite this, USDA data shows significant spending on the new counter-cyclical payment during the course of 2003, 2004 and 2005.

The EU priorities towards the US in the Doha negotiations are to achieve full parallelism in export competition, to ensure that the US will reform and reduce its trade-distorting domestic support and lastly, to improve our access to the US market.

Aircraft and Aero-engines

As far as civil aircraft are concerned, three international agreements are relevant: the WTO, the *1979 GATT Agreement on Trade in Civil Aircraft*, and the *1992 EU-US Agreement on Trade in Large Civil Aircraft (Bilateral Agreement)*. This latter agreement regulates precisely the forms and level of government support for both sides, provides for transparency and commits the parties to avoiding trade disputes. It focuses on the limitation of *both* direct (e.g.

repayable launch investment) and indirect (e.g. in the form of R&D benefits) government support. In October 2004 the US, without any legal basis, declared the unilateral abrogation of the Bilateral Agreement.

The implementation of the Bilateral Agreement has suffered in practice from a divergence of interpretation on the indirect support discipline. This has created a *de facto* increasing imbalance of obligations. Despite billions of dollars in public funding for NASA and DoD aeronautics R&D budgets, the US has so far hardly admitted any benefit to its large civil aircraft industry.

According to estimates carried out for the EU, these benefits to civil aircraft manufacturers have regularly amounted to several billion US$ annually (e.g. up to $2.98 billion in 2004). In the case of Boeing, these subsidies represented 13.9% of the company's total turnover in 2004 (up from 8.6% in 2002, to 11.9% in 2003, whereas the limit established by the Bilateral Agreement is 3%).

The EU has also expressed its concern over legislation (*Fiscal Year 2002 Defense Appropriations Act*) that would have allowed 100 tanker aircraft to be ordered by the US Air Force (USAF) from Boeing (KC-767A tanker program) without allowing real competition from EADS/Airbus, which would have resulted in procurement at a price substantially above the market value of the aircraft. This legislation helped cause a procurement scandal within the Air Force leading to several criminal, legislative, and administrative investigations of both government and Boeing officials. In the wake of these investigations, the *Fiscal Year 2005 Defense Authorization Act*, which would seem to allow for competition, and the pledge by DoD (following a report of the DoD Inspector General on this matter) to seek such competition should the Air Force decide it needs new aircraft, chances for true competition appear much better. The European Commission will continue to monitor the situation.

Section 106 of the *Federal Aviation Administration's* (FAA) four-year reauthorisation bill, *"Vision 100 – The Century of Aviation Reauthorization Act"*, which was signed into law on 12 December 2003, allows the Department of Transportation to provide war risk insurance to US aircraft and engine manufacturers for loss of an aircraft in excess of $50 million or in excess of the manufacturer's primary insurance. The *Fiscal Year 2006 Departments of Transportation, Treasury Appropriations Act* extends this possibility for yet another year. Coverage is also provided for aircraft manufacturer liability for third party claims arising out of acts of terrorism and would last until 30 March, 2008. Such coverage is clearly a subsidy not available to foreign competitors.

The EU is also concerned by US Government subsidies granted to US engine manufacturers in the form of benefits from R&D funded by NASA, the DoD - dual use technology - and other mechanisms such as prohibited export subsidies (FSC/ETI). GE and Pratt & Whitney are the dominant beneficiaries. These subsidies, which are non-repayable and can be directly traced to specific engine programmes, average around $2 billion annually.

EU WTO action against Boeing subsidies

On 6 October 2004, the EU requested WTO consultations with the US regarding subsidies granted to Boeing. The EU considers that the US Government has been following now for a number of years a policy of systematic and persistent subsidisation of Boeing through a number of measures involving, *inter alia*, paying research and development costs through NASA and the DoD – estimated at $22 billion over the past decade – as well as through the Department of Commerce and other government agencies.

The latest and most significant violation consists of massive subsidies in the form, *inter alia*, of tax reductions and exemptions and infrastructure support for the development and production of Boeing's 787 at the state and local levels. These include subsidies worth more than $7 billion which Washington State has offered to Boeing over the next 20 years for the envisaged production of its 787 aircraft, as well as significant transfers of economic resources and tax exemptions granted to Boeing in the States of Kansas and Illinois.

Moreover, the US Government continues to grant Boeing around US$ 100-200 million each year in export subsidies under the *Extraterritorial Income Exclusion Act* and the *American Jobs Creation Act* (the successors to the 'FSC' – Foreign Sales Corporation legislation) despite WTO rulings expressly declaring these subsidies illegal (see Section 5.10 on Subsidies - Foreign Sales Corporations).

The EU considers that the above mentioned subsidies are in violation of the SCM Agreement and the GATT 1994. Consultations were held in Geneva on 5 November 2004. On 12 January 2005, the US and the EC agreed to suspend WTO action for 3 months pending discussions towards the conclusion of a new bilateral agreement on subsidies for Large Civil Aircraft.

The Panel was established on 20 July 2005, and composed on 17 October 2005. This was followed by an information-gathering exercise under Annex V of the SCM Agreement in the last four months of 2005. The examination by the Panel of substantive issues is due to start in the beginning of 2006.

State Aid for US Airlines

Whilst recognising the severe financial consequences of the events of 11 September 2001 on US airlines and the need to ensure that vital transport services in the US were maintained, there are concerns about the scale of financial assistance provided by the US Government to US air carriers (see Section 8.5 on Transport Services).

Shipbuilding

The signing of the *Organisation for Economic Co-operation and Development* (OECD) *Shipbuilding Agreement* in December 1994, which was negotiated upon a request by the US and was meant to eliminate aid to the shipbuilding sector, was a major achievement and was expected to have a significant impact on US and all other signatories' subsidy programmes and hence reduce unfair practices in the shipbuilding sector. The Agreement aimed to eliminate all direct and indirect support and to combat injurious pricing practices.

In December 1995 the EU, South Korea and Norway (and in June 1996 Japan), ratified the Agreement. The failure of the US to ratify the Agreement due to opposition in Congress originating from pressure from the naval industry basically resulted in the death of the 1994 agreement. Negotiations for a new Agreement are suspended.

The market share of US shipbuilders declined further, making a US participation in a new agreement basically irrelevant and US yards are no longer competitive enough to build merchant ships for export (the price of US-built merchant ships is now typically 3 to 4 times the world market price). The domestic market for the US Navy and the protective *Merchant Marine Act of 1920* (so-called *Jones Act*), which reserves the construction of the vessels used for coastwise traffic to US shipbuilders, provides shipyards with orders, but the lack of international competition has fundamentally eroded the competitiveness of yards. The Jones Act, as amended, provides for various shipbuilding subsidies and tax deferments for projects meeting domestic-built requirements. These are provided via the *Operating Differential*

Subsidy (ODS), the *Capital Construction Fund* (CCF) and the *Construction Reserve Fund* (CRF).

In addition, the US Administration introduced a programme, the *Capability Preservation Agreement Scheme*, which was signed into law on 18 November 1997 (PL 105-85). This scheme allows qualified shipyards to claim for reimbursement on their US Navy shipbuilding contracts for certain costs attributable to work on their commercial shipbuilding.

The Jones Act also established under its Title XI, the *Loan Guarantee Program* to assist in the development of the US merchant marine by guaranteeing construction loans and mortgages on US flag vessels built in the US. In 1993, the guarantee programme was extended to cover vessels for export. For Fiscal Year 2004, the Maritime Administration (MARAD) approved $152 million in loan guarantees. For Fiscal Year 2005, MARAD approved $140 million in loan guarantees. Since Fiscal Year 1994, the Title XI programme has guaranteed loans for 112 different proposals covering $7 billion in loans for 753 vessels. The OECD implementing legislation would have had to provide for the amendment of these loan guarantees in order to put them in conformity with the rules of the 1994 Understanding on export credits for ships, which would have entered into force together with the OECD agreement. The US industry would like to retain this scheme that has helped to revitalise the sector. In the meantime, a new *Sector Understanding on Export Credits for Ships* took effect on 15 April 2002 as an Annex to the Arrangement on Guidelines for Officially Supported Export Credits. The US is not a participant to this new Sector Understanding.

6 INVESTMENT RELATED MEASURES

6.1 Direct Foreign Investment Limitations

The EU continues to be concerned about the current significant restrictions to foreign investment, especially the ambiguous provisions of the *Exon-Florio Amendment*, the imposition of conditional national treatment by many US laws, and the remaining restrictions in sectors such as shipping and communications.

National security considerations: Exon-Florio provisions

Section 5021 of the 1988 Trade Act, the so-called *Exon-Florio Amendment to the Defense Production Act*, authorises the President to investigate the effects on US national security of any merger, acquisition or take-over that could result in foreign control of legal persons engaged in interstate commerce. This screening is carried out by the Department of Treasury-chaired Committee on Foreign Investment in the US (CFIUS). The length of time taken by the screening process, the uncertainty, and the legal costs involved can act as a deterrent to foreign investment. Moreover, should the President decide that any such transactions threaten national security – which is widely interpreted -- he can take action to suspend or prohibit these transactions. This could include the forced divestment of assets since there is not statute of limitation for the control by the CFIUS. There are no provisions for judicial review or for compensation in the case of divestment. Since this legislation was introduced, the scope of Exon-Florio has been further enlarged.

Since 1992, an Exon-Florio investigation must be made if a foreign government-owned entity engages in any merger, acquisition or take-over that gives it control of the company. Further provisions contain a declaration of policy aimed at discouraging acquisitions by and the award of certain contracts to such entities.

The *1993 Defense Authorization Act* requires a report by the President to Congress on the results of each CFIUS investigation and includes, among other factors to be considered, “the potential effect of the proposed or pending transaction on US international technological leadership in areas affecting US national security”, again blurring the line between industrial and national security policy.

The Exon-Florio provisions thus inhibit the efforts of OECD members to improve the free flow of foreign investment and could conflict with the principles of *the OECD Code of Liberalisation of Capital Movements* and the *National Treatment Instruments*, although the US has notified reservations under these instruments for Exon-Florio.

While the EU understands the wish of the US to take all necessary steps to safeguard its national security, there is continued concern that the scope of application may be carried beyond what is necessary. In this context, the EU has drawn attention to the lack of a definition of national security and the uncertainty as to which transactions are notifiable. Although the US Treasury’s implementing regulations, which were published in November 1991, did provide some additional guidance on certain issues, many uncertainties remain. Coupled with the fear of potential forced divestiture, many if not most, foreign investors have felt obliged to give prior notification of their proposed investments. In effect a very significant number of EU firms' acquisitions in the US are subject to pre-screening.

In this context, recent efforts to extend the scope of the Exon-Florio Amendment to include economic and energy security and to give Congress the possibility to override a Presidential decision not to block a foreign acquisition raises concerns. The European Commission is of the view that such amendments are unnecessary as the President already has discretion to block a transaction that legitimately threatens national security and that such amendments would be contrary to US interests at home and abroad.

Foreign ownership restrictions

With regard to foreign ownership, the US has informed the OECD of a number of additional restrictions that it justifies "partly or wholly" on the grounds of national security. Foreign investment is restricted in coastal and domestic shipping under the *Jones Act* and *the US Outer Continental Shelf Lands Act*, which includes fishing, dredging, salvaging or supply transport from a point in the US to an offshore drilling rig or platform on the Continental Shelf. Foreign investors must form a US subsidiary for exploitation of deep-water ports and for fishing in the US Exclusive Economic Zone (*Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987*). Under the *American Fisheries Act of 1998*, fishing vessel-owning entities must be at least 75% owned and controlled by US citizens in order to document a vessel with a fishery endorsement. Licences for cable landings are only granted to applicants in partnership with US entities (*Submarine Cable Landing Licence Act of 1921*).

Under the *Federal Power Act*, any construction, operation or maintenance of facilities for the development, transmission and utilisation of power on land and water over which the Federal government has control, are to be licensed by the Federal Energy Regulatory Commission. Such licenses can be granted only to US citizens and to corporations organised under US law. The same applies under the *Geothermal Steam Act* to leases for the development of geothermal steam and associated resources on lands administered by the Secretary of the Interior or the Department of Agriculture. Regarding the operation, transfer, receipt, manufacture, production, acquisition and import or export of facilities which produce or use nuclear materials, the *Nuclear Energy Act* requires that a licence be issued but the licence cannot be granted to a foreign individual or a foreign-controlled corporation, even if there is incorporation under US law.

Significant limitations to foreign investment also remain in the US communications market (see Section 8.2 on Communications Services) and the air transport market (see Section 8.5 on Transport Services).

6.2 Tax Discrimination

Several aspects of US taxation practices constitute additional difficulties to foreign investment in the US market. Those are mainly related to the nature of reporting requirements, conditions for deductibility of interest payments and State "world-wide" unitary taxes. In addition, the US has largely remedied the WTO inconsistency of its *Foreign Sales Corporations* (FSC) legislation, and its replacement, the *FSC Repeal and Extraterritorial Income Exclusion Act* (ETI) considered as an export subsidy by the WTO Appellate Body with the passage of the *American Jobs Creation Act of 2004* (see Section 5.10 on Subsidies).

Reporting requirements

The information reporting requirements of the US tax code as applied to certain foreign-owned corporations mean that domestic and foreign companies are treated differently. These rules apply to foreign branches and to any corporation that has at least one 25% foreign shareholder. They require the maintenance or the creation of books and records relating to transactions with related parties. The documents must be stored at a place specified by the US tax authorities and an annual statement filed containing information about dealings with related parties. There are stiff penalties for non-compliance with the various provisions. These requirements are onerous. Although their purpose, the prevention of tax avoidance and evasion, is reasonable, they are burdensome and add to the complexity for foreign-owned corporations of doing business in the US.

"Earnings stripping" provisions

The so-called “earnings stripping” provisions in the *Internal Revenue Code 163j* limit the tax deductibility of interest payments made to “related parties” which are not subject to US tax, and of interest payments on loans guaranteed by such related parties. In practice, most “related parties” affected will be foreign corporations.

These provisions are designed to prevent foreign companies from avoiding US tax by financing a US subsidiary with a disproportionately high amount of debt as compared with equity, with the result that profits are repatriated from the US in the form of deductible interest payments rather than as dividends out of taxed income. The underlying tax policy considerations concerning such legislation are internationally widely accepted and many other industrialised countries have similar rules in their tax systems. However, the US rules for calculating the ceiling on the amount of admissible interest, are relatively strict and their application may produce results that do not necessarily always conform to the internationally accepted arm’s-length principle.

Moreover, as these provisions are only applied to interest paid on loans taken with or guaranteed by related parties that are not subject to US tax, they may also discriminate against foreign-owned US companies by imposing on them more onerous conditions for the raising of funds than what is applicable to domestically held US companies. Such legislation can therefore act as a barrier against foreign direct investment flows into the US.

State unitary income taxation

Certain US States assess state corporate income tax for both domestic and foreign-owned corporations on the basis of an apportionment of their total US profits. The formulae and factors for apportioning the profits are established by each individual state and there is no single common method. As a result a company may have to pay tax on the same income in more than one state, giving rise to double taxation.

World-wide unitary taxation

Any extension of US state unitary income taxation to worldwide unitary taxation is inconsistent with bilateral tax treaties concluded by the US at the Federal level, and a company may face heavy compliance costs in providing details of its worldwide operations. International attention has focused mainly on California, which until 1986 sought to tax a share of world-wide profits. However, since 1986 it has allowed companies to elect for “water’s edge” unitary taxation. Under this method, companies are taxed on the basis of a share of their total US (rather than worldwide) income. The 1994 US Supreme Court ruling that California’s former worldwide unitary tax was constitutional was not encouraging. The

EU and its Member States remain concerned about world-wide unitary regimes introduced on a unilateral basis and will keep a watch on possible developments.

7 INTELLECTUAL PROPERTY RIGHTS

Several aspects of the US intellectual property legislation are inconsistent with US international commitments (e.g. the lack of prompt notification of government use of patents, or the insufficient protection of geographical indications). Some of those US provisions have been found incompatible with the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) Agreement by DSB rulings (i.e. Section 110(5) of the US Copyright Act, and Section 211 of the Omnibus Appropriations Act). Moreover, the "first-to-invent" principle governing US patent registration continues to create considerable interface problems for EU companies, not to speak of the financial effects of high litigation costs in patent matters.

7.1 Copyright and related areas

Moral rights

Despite the obligation contained in *Article 6bis of the Berne Convention*, to which the US acceded in 1989[6], to make "moral rights" available for authors, these rights are recognised only to a very limited extent in US legislation.

During the passage of the Berne Convention Implementation Act, the US Congress specifically stated in 1988 (Senate Report 100-352) that rights equivalent to moral rights of authors were already recognized in the US under:

1. the common law of misrepresentation and unfair competition;
2. § 43(a) of the Lanham Act, 15 USC § 1125(a)(1)(A), which prohibits "false designation of origin, false or misleading description of fact" that is "likely to cause confusion, ... mistake," or deception about "the affiliation, connection, or association" of a person with any product or service;
3. defamation (libel) law.

Therefore, Congress asserted that law in the US already complied with Article 6bis BC. In that context, it must be noted that 17 USC § 104(c) specifically prohibits any person in the US from relying on the protection of any right or interest specified in the Berne Convention, i.e., all rights in the US must derive from US statutory or common law.

In 1990, the US Congress passed the Visual Artists Rights Act, 17 USC § 106A that granted authors of visual art (e.g., painting, drawing, print, sculpture, still photographic image) the following rights of attribution:

- the right to claim authorship
- the right to prevent his/her name from being attached to works that he/she did *not* create

[6] It must, however, be noted that the Berne convention's moral rights provisions are specifically excluded from the TRIPS agreement (art 9):" …Members shall not have rights or obligations under this agreement in respect of the rights conferred under art 6bis of that convention or of the rights derived there from".

- the right to prevent use of his/her name as the author after mutilation, distortion, or other modification of the work that is prejudicial to his/her honour or reputation

and the following rights of integrity:

- prevent any intentional mutilation or distortion of the work that is prejudicial to his/her honour or reputation
- prevent destruction of a work of recognized stature

US authors benefit from moral rights in certain Member States of the EU. It is noted that the US has ratified and implemented the *World Intellectual Property Organisation (WIPO) Copyright Treaty* and the *WIPO Performances and Phonograms Treaty*. Adherence to these Treaties by the US requires legislation on moral rights at least for performers.

Licensing of music works

Section 110(5) of the 1976 US Copyright Act provides for an exemption to the author's exclusive rights to authorise the communication of their works to the public ("homestyle exemption"). Concretely, Section 110(5) permits the playing of broadcast music in public places (such as bars, shops, restaurants etc.) without the payment of a royalty fee.

The described practice has caused a loss of income to right-holders, as a large number of commercial establishments do not pay any royalty fees. Moreover, the incomplete copyright protection in the US has broader economic effects negatively affecting the overall position of authors on the US market.

At the request of the EU and its Member States, at the DSB meeting of 25 May 1999, a Panel was established.

The Panel report, circulated on 15 June 2000, found that the most important part of Section 110(5) (sub-paragraph B) is in breach of US obligations under the TRIPs Agreement. An Arbitration Panel determined on 9 November 2001 that the level of nullification and impairment of EU benefits was equal to $1.1 million per year. In view of the US failure to bring its legislation into conformity with the TRIPS Agreement within a reasonable period of time, the EU agreed to negotiate an interim arrangement for the benefit of EU right holders affected by the operation of Section 110(5) (B) of the US Copyright Act. The parties eventually notified to the WTO a mutually satisfactory temporary arrangement on 23 June 2003. Under the arrangement, the US provided financial assistance to EU music rights societies with a view to developing activities for the promotion of authors' rights.

The temporary arrangement expired on 20 December 2004 and the US has not yet brought its Copyright Act into compliance with the TRIPs Agreement. This longstanding situation of non-compliance undermines the foundations of the WTO and casts serious doubts on the credibility of the US commitment to international standards in the intellectual property field. This issue also affects negatively the scope for EU-US co-operation in IP matters. The EU has safeguarded its rights to suspend trade benefits granted to the US if the Copyright Act is not amended.

7.2 Appellations of Origin and Geographical Indications

Wine

The EU-US agreement on trade in wine initialled on 14 September 2005, though not dealing with intellectual property rules, provides for a recognition and protection of the wine names of origin of either Party via their labelling rules. In addition specific provisions are foreseen with regards to the 17 EU wine names currently considered as semi-generics in the US, to restrict their use in the US to European wines only, in the future (see Section 5.1 on Regulatory Divergences and Barriers).

This agreement is a first step agreement and negotiations for the conclusions of one or more agreements are due to begin within 90 days of the entry into force of this agreement. A joint declaration attached to this agreement provides that issues such as geographical indications and the future of the “ex” semi-generics on the US market will be on the agenda of this second phase negotiation.

The European Commission is hopeful that, building on the conclusion of this first phase agreement, a constructive dialogue can start to better understand and hopefully narrow the gap on each other’s positions on geographical indications.

7.3 Patents, Trademarks and related areas

Measures affecting imported goods

Section 337 of the US 1930 Tariff Act

Section 337 of the Tariff Act of 1930 provides remedies for holders of US intellectual property rights by keeping the imported goods which are infringing such rights out of the US (“exclusion order”) or to have them removed from the US market once they have come into the country (“cease and desist order”). These procedures are carried out by the US International Trade Commission (ITC) and are substantially different from the internal procedures in the case of domestic goods that allegedly infringe US intellectual property rights. Notably, the means of defence under the Section 337 procedure are limited. Under the *1988 Omnibus Trade and Competitiveness Act*, several modifications have been introduced to Section 337, such as the availability of remedies in relation to imported goods that infringe a US process patent. The GATT Panel report, which was adopted by the Contracting Parties in November 1989, concluded that Section 337 was inconsistent with Article III:4 GATT. The provision in question accords to imported products alleged to infringe US patent rules treatment less favourable than that accorded to like US products. Some modifications have been made to Section 337 in the context of implementing TRIPs. However, in its present form, Section 337 does not eliminate the major GATT inconsistencies raised by the 1989 GATT Panel. As a result, Section 337 appears to continue to be in violation of Article III: 4 GATT and of a number of provisions contained in TRIPs.

On 28 February 2000, the EU and its Member States held WTO consultations, with no positive outcome. Since then, the ITC has started new investigations against a number of European and Canadian companies, a new type of which is beginning to raise concerns, that is, claims which are legally weak and - in the absence of any abusive claim or dilatory claim concepts applicable to the Section 337 procedure - appear to have no other purpose than to compel the European defendants to settle. The European Commission is concerned by these developments and it regularly raises the Section 337 issue in its bilateral contacts with the US Administration. The European Commission does not discount further action at the WTO level.

Advertising practices on EU perfume imitations

Advertising low price perfumes imitating famous European brands, and thus benefiting from the well-known reputation of the European brands, is not prohibited in the US. This practice may violate *Article 6bis* and/or *Article 10bis of the Paris Convention* (concerning confusion and unfair competition, respectively), as incorporated into the TRIPs Agreement through its *Article 2.1*.

US Government use of patents

Article 31 of the TRIPs Agreement introduces a requirement to inform promptly a right holder about government use of his patent. The manufacture or use of patented goods by or for the US Government authorities is apparently extremely widespread. However, it appears that US Government departments frequently fail to comply with the above-mentioned obligation. Right holders, and particularly foreign ones, are therefore likely to miss the opportunity to initiate an administrative claims process.

US "First-to-invent" system for patent registration

European companies are faced with indirect costs resulting from the 'first-to-invent' system for patent registrations in the US. The US patent system is the only one to apply the principle of 'first-to-invent'. The rest of the world follows the principle of 'first-to-file', fixing thereby a clearly defined moment when the priority right to a patent is established. The 'first-to-invent' principle creates several obstacles for EU and US companies trying to obtain a patent right in the US, namely because it has a considerable economic impact on the potential right holder. It is hoped that recent movements in the US Congress towards the adoption of the first-to-file system will bring the US system into conformity with the rest of the world.

The Hilmer doctrine

European companies are confronted with discrimination due to the application of the “Hilmer doctrine” which does not follow the rule that the prior art which is relevant for assessing the novelty and the inventiveness of an invention may be defined as all information which has been available to the public anywhere in the world in any form before the priority date of a claimed invention. Furthermore, an international application (PCT) arising from European countries is not included in the US prior art until the date of the entry into the US national phase even if that application has been published previously.

This doctrine is clearly detrimental for European companies although it is authorised by Article 27(5) of PCT.

Patentability of software and business methods

US and European law take different approaches to the question of patents covering entities such as innovative business methods and computer programmes. Generally, such subject matter can be patented in the US, but not in the EU and many other countries unless the subject matter of the patent is not a computer programme “as such” and it has a distinctive technical character. This requirement, known as the "technical contribution" requirement, exists at present primarily in case law but would have been codified and harmonised under Community law by a Directive which was proposed by the European Commission in February 2002 and has been rejected by the European Parliament. It is no longer under discussion.

This difference in approach means that EU companies operating on the Internet or directly in the US market may encounter problems if their activities are free of patents in their home markets but fall within the scope of valid US patents.

The "technical contribution" issue along with "first to file/first to invent" and other questions of substantive patent law (such as a grace period and utility/industrial application), are the subject of on-going negotiations in the context of the WIPO discussions on the draft *Substantive Patent Law Treaty*.

Section 211 of the US Omnibus Appropriations Act

Section 211 of the Omnibus Appropriations Act, adopted in October 1998, prohibits, under certain conditions, the registration or renewal of a trademark that is identical or similar to a trademark previously owned by a confiscated Cuban entity and sets forth that no US Court shall recognise or enforce any assertion of such rights.

In the view of the European Commission and the Member States, Section 211 violates several provisions of the TRIPs Agreement, notably on national treatment and most-favoured-nation treatment, the protection of trademarks and enforcement. Section 211 was already applied in a case involving a European company that was not able to defend its trademark rights before a US court as a consequence.

After WTO consultations failed, in March 2000 the EU and its Member States decided to request the establishment of a WTO Panel on Section 211. The Panel's report was issued on 6 August 2001 and confirmed that Section 211 was in violation of *Article 42 of TRIPs* by denying trademark owners access to the courts. Furthermore, it stated expressly that Section 211 should not apply when the trademark has been abandoned. However, there were two points where the Panel did not agree with the EU's interpretation of the compatibility of Section 211 with WTO rules. The Panel considered that trade names are not covered by TRIPs and that TRIPs does not regulate the question of the ownership of intellectual property rights.

Both the EU and the US decided to appeal the Panel ruling. The Appellate Body report was issued on 2 January 2002. According to this report, Section 211 is in violation of both the national treatment and the most favoured nation obligations of the TRIPs. The Appellate Body held that, in pursuing their policy against confiscation of assets in foreign territory, the US cannot discriminate in favour of US right holders or treat Cubans less favourably than other foreigners. The decision is also satisfactory from a systemic viewpoint, as it reversed the panel finding that trade names are not covered by the TRIPs discipline: the Appellate Body confirmed that, under the TRIPs, WTO Members do have an obligation to protect trade names. However, the Appellate Body found that the US statute was in conformity with Article 42 of the TRIPs Agreement, thereby reversing the panel findings on that point.

The reasonable period of time for the US implementation of the WTO ruling originally agreed to expire no later than 3 January 2003 was extended several times and finally expired on 30 June 2005. The EU has not requested retaliation but concluded an agreement with the US preserving the right to do so at a later stage. The agreement was endorsed by a decision of the WTO Dispute Settlement Body on 20 July 2005.

8 SERVICES

8.1 Business Services

Professional Services in general

Following the conclusion of the GATS negotiations in 1993, the access of professional service suppliers to the US has been improved since a number of nationality conditions and in-State residence requirements have been removed.

However, despite the improvements contained in the schedule of specific commitments, access to the US market, where licensing of professional service suppliers is generally regulated at State level, remains unsatisfactory. This is mainly due to the lack of transparency in -and divergence of- access conditions at State level, as well as the frequent absence of a transparent regulatory regime for the operation of foreign professional service suppliers. In addition, the application of Buy America and positive discrimination provisions, as well as burdensome visa procedures for registration and for obtaining work permits, make it difficult for foreign suppliers of professional services to enter the US market.

Nonetheless, the situation should improve steadily under the GATS: the Working Party on Professional Services has agreed on disciplines applicable to accountancy services, and the Working Party on Domestic Regulation will continue working on the disciplines necessary to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade. In addition, negotiations on market access and on the further liberalisation of professional services are taking place as part of the WTO Doha Development Agenda.

Auditing services

The *Sarbanes-Oxley Act of 2002*, adopted as a reaction to US corporate scandals, has a significant impact on US-listed EU companies as well as on EU auditing firms, which could face conflicting laws on audits and corporate governance. In the rule-making process for the implementation of the Act, the US *Securities and Exchange Commission* (SEC) and the Public Company Accounting Oversight Board (PCAOB) have minimised this impact to a certain extent, namely in the area of corporate governance. Progress has been made on several original EU concerns, most notably on the registration of non-US auditors with the newly established US PCAOB, where a parallel track approach between the EU and US has been developed, embodied in the European Commission's proposal to amend the Eighth Company Law Directive and PCAOB rules.

8.2 Communication Services

2005 was marked by a number of important mergers that showed a clear trend towards consolidation in the US market both in the wire line (notably with the purchase of AT&T by

SBC and MCI by Verizon) and wireless telecommunication sectors (Sprint-Nextel and ALLTEL-Western Wireless mergers).

The reduction in the number of competitors in the wire line sector raises some concerns, in particular, regarding the provision of local connectivity (namely special access lines for businesses requiring dedicated, non-switched connections to external networks), as well as Internet connectivity services. On the one hand, special access lines are key inputs for the provision of global telecoms services and particular attention will be required to ensure a fair and non-discriminatory special access offer. On the other hand, several submissions to the Federal Communications Commission (FCC) in the above mentioned proceedings have also expressed concerns about a reduction of competition in the internet backbone market leading to “de-peering”, dominance and packet-discrimination concerns.

Meanwhile, the FCC has continued its work on several key proceedings concerning the provision of unbundled network elements by incumbent local exchange carriers, IP-enabled services, its ambitious “Broadband Agenda” and the allocation of spectrum for advanced wireless services. A number of court decisions have had a noticeable impact on some of the recent FCC rulings: on the one hand, the FCC has had to revise several times its “Triennial Review Order” concerning unbundled network elements, notably with respect to local access in residential markets as a result of a succession of court rulings vacating its decisions; on the other hand, the Supreme Court supported the FCC Declaratory Ruling classifying cable modem broadband service as an “information service”, allowing the FCC to proceed with its deregulatory approach to broadband services.

In general terms the FCC seems to favour the progressive establishment of a model based on competition between infrastructure-based operators (at least for advanced services). Competition based on the services provided (where new entrants rely on the access to certain elements of the incumbents’ network to enter and compete in the market) may prove more difficult in the future. The effects of the new regulatory framework emerging in the US on the establishment of foreign operators will have to be properly examined, in particular, the FCC’s new rules on the provision of unbundled network elements (UNEs) by incumbent local exchange carriers, which became effective on 11 March 2005. The US regulatory framework remains unstable as a result of court proceedings, including at State level, and the possibility that Congress will re-write the Telecommunications Act in whole or in part in the coming year makes it difficult so far to weigh the implications for trade and investment of the current regulatory framework.

Furthermore, the FCC classified in August 2005 high speed Internet access services (via wire line and cable modem) as “information services”, rather than telecommunications services. As a result, after a one-year transition period, facilities-based wire line broadband Internet access service providers will no longer required to separate out and offer the wire line broadband transmission component of wire line broadband Internet access services as a stand-alone telecommunications service, separately from their Internet service.

This order follows the US Supreme Court’s opinion in *NCTA v. Brand X,* in which the Supreme Court upheld the FCC’s earlier determination that cable modem broadband services may be classified as information services, rather than as traditional telecommunications services. As a result, regulatory disparities between telephone companies and cable companies in the provision of broadband service are being narrowed, although the issue of local franchise fees applicable so far only to cable providers, remains to be addressed.

Whether such a classification may affect competition and the ability of new players to enter the US market will have to be assessed. This question is equally linked to the proposed change in the classification of certain services in the US initial offer in the current GATS negotiations (e.g. the classification of packet switched data transmission services as information services and no longer as basic telecommunication services or the creation of a new category of "other communications services", which may result in the non-application of the provisions of the so-called GATS Reference Paper on Pro-competitive Regulatory Principles to services that otherwise would be covered by it).

Overall, the US regulatory framework needs a comprehensive review to streamline it and make it less segmented along “legacy technology” lines. A more flexible approach based on straightforward analysis of problematic market situations and identification of targeted adequate remedies rather than ad hoc legislative and/or regulatory solutions as new technologies and services develop would allow the regulator to focus on substantive competition issues where they arise and to apply targeted remedies. A more comprehensive and technology neutral approach to regulation of communications services would also address in a consistent manner public security or consumer protection issues that concern ultimately all communications services.

Despite the commitments made in the WTO and especially those pursuant to the GATS Basic Telecommunications negotiations concluded in 1997 and which entered into force in February 1998, European and other foreign-owned firms seeking access to the US market have faced substantial barriers, particularly in the satellite sector (which has suffered from lengthy proceedings, conditionality of market access and *de facto* reciprocity-based procedures) and the mobile sector (e.g. investment restrictions, lengthy and burdensome proceedings and protectionist attitudes in certain congressional circles). A number of changes have been introduced, in particular in relation to the US spectrum management policy and licensing procedures in the satellite sector (see below). The EU notes these and other gradual improvements on a number of issues, but since some of the previously identified obstacles remain, must conclude that market access is still not fully ensured and this situation is not in line with the market access policy advocated by the US.

In addition, the impact of the events of 11 September 2001 has been felt in the telecoms sector as US law enforcement agencies, in implementing the so-called Exon-Florio statute, have imposed strict corporate governance requirements on companies seeking FCC approval of the foreign takeover of a US communications firm in the form of network security arrangements going further than before.

WTO commitments on telecommunications services

The US first scheduled commitments in the WTO on value added services (such as electronic mail or electronic data interchange) at the end of the Uruguay Round in 1994. However, these commitments are limited to those services supplied over common carrier networks (thereby excluding cable networks, for instance) and are based on a domestic definition of the "value-added nature" of the services, which introduces uncertainty as to the scope of the US commitments. The US also scheduled commitments on broadcasting services (radio and television transmission services), allowing access to its market while retaining restrictions on the share of foreign ownership.

Negotiations on Basic Telecommunication services conducted in the framework of the GATS under the auspices of the WTO were concluded successfully on 15 February 1997 in the form of a Fourth Protocol to the GATS. At that time, 69 governments undertook legally binding commitments on access to their telecommunications services’ market, thereby liberalising a global market estimated to be worth approximately $600 billion (i.e. over 90% of total global revenues for telecommunications services). The Fourth Protocol to the GATS, more commonly known as the *WTO Basic Telecom Agreement* entered into force in February 1998.

At the time, the US undertook market access and regulatory commitments on most telecommunications services (voice telephone, data, telex, telegraph, private leased circuit services; local, domestic, long-distance and international; etc.). Regulatory commitments in particular impose that the US regulation be in line with a number of principles to have i.a. adequate licensing procedures, to promote competition, and to ensure proper interconnection. The US however retained several restrictions notably on market access. Foreign direct investment in US companies holding common carrier radio licences is limited to 20% (indirect investment being allowed up to 100%). The US also kept a market access restriction on satellite-based services, namely the monopoly of Comsat to link up with Intelsat and Inmarsat (US legislation, the *ORBIT Act*, removed the Comsat monopoly in 2000, see below). Late in the negotiations, the US took an exemption to the MFN principle for one-way satellite transmission of Direct to Home (DTH), Direct Broadcast Satellite (DBS) and digital audio services. This MFN exemption allows discriminatory treatment of foreign companies and may impair European interests. The EU reserved its right to challenge this exemption as it applies to services that are part of the audio-visual commitments undertaken by the US in 1994 as a result of the Uruguay Round.

In November 1995, in the run-up to the WTO negotiations on Basic Telecommunications, the Federal Communications Commission (FCC) adopted a rule on entry of foreign-affiliated carriers into the US market, adding a new factor to the FCC's public interest review for the purpose of granting waivers to those restrictions on foreign indirect investment imposed by *Section 310 of the 1934 Communications Act*. Specifically, the FCC introduced an "Effective Competitive Opportunity Test" (ECO-test). The FCC also issued in May 1996 a notice of proposed rulemaking applying the ECO-test to foreign-licensed satellites. The EU submitted objections in both proceedings. On 25 November 1997, the FCC adopted two rulings (a general ruling on foreign participation in the US market, and a specific one on the satellite services market entitled DISCO-II) to implement the commitments of the US in the Basic Telecom Agreement. In these rulings the FCC replaced the ECO-test with a rebuttable presumption that entry by carriers from WTO countries and by satellites licensed by WTO countries is pro-competitive, but the FCC retained the unclear "public interest" criteria which can still be invoked to deny a licence to a foreign operator for various motives, such as "trade concerns", "foreign policy concerns" and "very high risk to competition". Although the FCC expressed its intention to only deny market access on this basis in exceptional circumstances (which are not well defined) the discretion retained by the FCC remains of concern to the EU and raises questions as to the compatibility of the FCC rules with US WTO commitments.

In March 2004, the FCC amended its International Communications Policy in recognition that markets have become more competitive but it re-affirmed the relevance of its "benchmarks" policy applicable to international settlement rates since 1997. This policy, which seeks unilaterally and arbitrarily to move these rates towards costs, may violate WTO rules. Concerns were heightened in 2004 as some parties sought to apply the Benchmarks' policy to the mobile communications sector. The FCC decided instead to initiate in October 2004 a Notice of Inquiry to evaluate the effects of high foreign mobile termination rates on US consumers and competition.

We note that the initial offer submitted by the US in the new round of negotiations envisages the possibility to eliminate the exemption to the MFN principle for one-way satellite transmission of Direct to Home (DTH), Direct Broadcast Satellite (DBS) and digital audio services and covers cable services provided over cable systems. However other restrictions described above appear to be maintained. Also, the reclassification of certain services as proposed in the offer would undermine previous regulatory commitments undertaken by the US, which is not compatible with the mandate of the GATS negotiations (article XIX) since it is a form of backtracking. Finally, some EU operators have expressed concern that the reference to state ownership in the US offer, unwarranted in the WTO forum, may be used against their entry into the US market: although this would be legally impossible under existing commitments.

Foreign investment

Section 310 of the 1934 Communications Act establishes restrictions to foreign investment in US companies holding a broadcast or common carrier radio license. The US has undertaken commitments in the framework of the Basic Telecom Agreement to suppress restrictions to indirect investment from 1 January 1998. However, the US Administration holds the view that it is not necessary to adopt specific legislation to abolish such investment restrictions, since the FCC may waive these restrictions under the current law by invoking the "public interest." The US Administration and the FCC consider that this waiver provision is sufficient for the FCC not to apply *Section 310(b) (4) of the 1934 Communications Act* to WTO Members. This situation, however, does not provide certainty to European operators.

Universal service

The current universal service and access charge regimes in the US require further clarification, in particular with a view to ensuring its competitive neutrality and that foreign consumers are not subsidising universal service obligations in the US.

Existing restrictions on access to the US market in specific communication sectors are described below.

Radio and mobile communications

Section 310 of the Communications Act of 1934 remains basically unchanged following the adoption of the *Telecommunications Act of 1996.* It contains restrictions on the holding and transfer of broadcast and common carrier radio communication licences: no broadcast or common carrier (or aeronautical en route or aeronautical fixed radio station) licence shall be granted to, or held by, foreign governments or their representatives, aliens, foreign corporations, or corporations of which more than 20% of the capital stock is owned or voted by a foreign entity (25% if the ownership is indirect subject to a public interest waiver). The one change brought about by the new Act was to eliminate the restriction on foreign directors and officers.

The Basic Telecom negotiations in the WTO did not change the situation with respect to foreign direct investment, as limitations on direct foreign ownership of common carriers radio licences have been explicitly retained in the US schedule of commitments.

To provide telecommunications services, operators typically need to integrate radio transmission stations, satellite earth stations and in some cases, microwave towers into their networks. Foreign-owned US operators face additional obstacles in obtaining the licensing of these various elements relative to US-owned firms.

Broadcast communications

Section 310 of the Communications Act of 1934 also applies to the broadcast sector: foreign direct investment in US companies holding a broadcast license is limited to 20%, and foreign indirect investment to 25% subject to a public interest waiver, a possibility the FCC has hardly used. As a result, the US broadcasting market today is hardly accessible to foreign media companies.

In the 1996 Telecommunications Act, Congress significantly relaxed many of the existing broadcast ownership rules (leading to substantial consolidation in the commercial broadcast radio industry) and mandated the FCC to review them every two years to determine "whether any of such rules are necessary in the public interest as a result of competition." Furthermore, recent court decisions underlined that such limits must reflect changes in the media market place and must be based on a solid factual record. The FCC was ordered to study and report on the current status of competition justifying with record evidence the need to maintain the ownership rules and their consistency.

Within this context, the FCC conducted a comprehensive review of its media ownership regulations. In June 2003 it adopted an Order relaxing previous restrictions (e.g. elimination of the local TV broadcast duopoly rule, increase from 35 to 45% of the cap on a TV broadcast network's reach of the national audience and elimination of the existing ban on broadcast-newspaper and radio-television cross-ownership in large markets and replacement of this ban by a set of cross-media limits in small and medium size markets). The Order was immediately challenged in the US Court of Appeals for the 3rd Circuit.

In June 2004, the 3rd Circuit US Court re-affirmed the FCC decision to eliminate the ban on media cross-ownership but called in question the FCC methodology in setting specific limits on media combinations and remanded the Order to the FCC. In January 2005, the FCC decided not to appeal to the Supreme Court. Although a number of broadcasters and publishers took the issue to the Supreme Court, the Court decided not to review the Third Circuit Court decision. The 3rd Circuit did not address the FCC broadcast TV network ownership rules because Congress in the meantime rolled back the cap from 45% to 39%.

Meanwhile, the FCC Order remains stayed, although FCC's new Chairman, Kevin J. Martin, has stated his intention to take up this issue again. In parallel, an attempt was made in Congress to re-instate the ban on media cross-ownership. An eventual relaxation of the rules may in the future allow the major US players to consolidate or swap their assets. Non-US companies will not be able to participate in this development because of the existing foreign ownership restrictions. For the future, the expected consolidation within the US broadcasting market will raise market entry costs for foreigners considerably.

Mobile communications: third generation systems

The FCC's Tenth Annual Report to Congress on the state of competition in the mobile telephone market concludes to the existence of effective competition in the mobile US market on the basis i.a. of the analysis of the number of competing carriers providing service in an area. However, the Report does not take yet into account the impact of recent mergers. There is a clear trend towards increasing consolidation in the industry and a reduction of the number of carriers which provide national wireless services. In this light, it is essential that operators willing to compete at a national or super-regional market have the possibility to access the spectrum they require to expand their footprint or offer new services, in order to achieve economies of scale and scope for the benefit of competition and consumers.

Previous Reports have expressed concern about the risk that access of third generation (3G) mobile communication systems to the US market could be restricted due to lack of availability of frequencies in the US. In this respect, in September 2001 the FCC added a mobile allocation to the 2500-2690 MHz band (designated in Europe for 3G/IMT-2000 services by CEPT in November 2002) to provide additional flexibility for use of this spectrum, thereby making this band potentially available for advanced mobile and fixed terrestrial wireless services, including 3G and future generations of wireless systems. In November 2002, the FCC issued another order allocating 2x45MHz of spectrum for advanced wireless services, including 3G and IMT-2000 services. This re-allocation concerns the 1710-1755MHz (allocated in Europe to GSM 1800) and which accounts for half of the spectrum the FCC currently plans to auction for Advanced Wireless Services, including 3G services and

21502155MHz (allocated in Europe to 3G mobile services) bands. Furthermore, the 2165-2180 MHz band was re-allocated to Fixed and Mobile services on a primary basis in order to promote the introduction of new advanced services, including Advanced Wireless Services.

On 25 November, 2003, the FCC adopted service rules for this spectrum (Advanced Wireless Services in the 1.7 GHz and 2.1 GHz Bands), including provisions pertaining to application procedures, licensing, technical operations, and competitive bidding. In September 2005 the 2155-2160 MHz band was re-allocated for Fixed and Mobile services and the 2155-2175 MHz band was designate for Advanced Wireless Services use.

However before these bands can be put to effective use, several steps are required; in particular existing users must be relocated. A letter of 23 April 2004 addressed by the National Telecommunications and Information Administration (NTIA) to the US Senate and the House leadership identified three major actions that should be taken to make the deployment of 3G services optimally possible: (1) under current rules, Federal agencies required to relocate or modify radio communications are entitled to reimbursement from the private sector. Congress has been requested to change the reimbursement process by creating a relocation fund using auction proceeds; (2) the completion of the FCC's rules to identify spectrum for some Federal operations that must relocate; and (3) scheduling by the FCC of an auction to license this spectrum by competitive bidding, which NTIA, however, would not support until identification of alternative frequencies for the affected Federal systems has been completed.

On 23 December 2004 the *Commercial Spectrum Enhancement Act* ("CSEA") was signed into law. A key element of CSEA is the establishment of a "Spectrum Relocation Fund" to reimburse the relocation costs of federal agencies currently operating on spectrum reallocated from federal to non-federal use. The spectrum covered by CSEA includes 216-220 MHz, 1432-1435 MHz, 1710-1755 MHz, and 2385 MHz-2390 MHz, as well as other spectrum bands that may be reallocated from federal to non-federal use. Also in December 2004, the FCC announced its intention to auction the 1710-1755 MHz and 2120-2155 MHz AWS spectrum in June 2006.

Finally, on 9 June 2005, the FCC adopted a Declaratory Ruling and Notice of Proposed Rule Making which launched the proceeding to implement rules and procedures needed to comply with the CSEA.

These developments are welcomed and encouraging, although delays may still occur before all these bands can be put to effective use. In particular, it is necessary to ensure that the US market is open to European and foreign country operators that are potential new entrants in the market, as well as to provide regulatory certainty to companies interested in investing in these new technologies in the US. Furthermore, it is important to ensure compatibility between the 3G frequency bands in the US and the EU so as to facilitate roaming between the US and the EU via multi-mode terminals.

Satellite Communications

The satellite sector has experienced a considerable reshuffle, as several companies have changed ownership.

European satellite operators have encountered serious difficulties in serving the US market as a result of the FCC application of its DISCO II public interest framework that considers the effect on competition in the US, spectrum availability, eligibility and operating (e.g. technical) requirements, and national security, law enforcement, foreign policy and trade concerns. These difficulties were compounded by the *ORBIT Act of 2000* which required, i.a., Intelsat, Inmarsat Ventures plc and New Skies N.V. to conduct Initial Public Offerings (IPOs) by a set deadline, and the FCC to apply the Act's privatisation criteria in order to determine whether to grant market access to these entities. President Clinton, on signing the bill into law, stated that certain provisions could interfere with the President's constitutional authority to conduct the Nation's foreign affairs", that he "will therefore construe the provisions as advisory", and that the Administration would continue to advise the FCC on matters concerning interpretation of and compliance with US WTO obligations. Nevertheless, there was serious concern on the part of the EU that these criteria applied to no other competitor, foreign or domestic, and could lead the FCC to limit these entities' access to the US market, thereby reducing competition in the US market (contrary to the explicit intent of the Act to promote competition). In that respect, the ORBIT Act violates WTO obligations and if it is used against EU operators' interests, the EU reserves its right to take the appropriate action under the WTO.

In the period 1999 to 2001, a number of cases were brought to the attention of the European Commission by Inmarsat Ventures plc, New Satellites N.V, Eutelsat, and SES Global. UK based Inmarsat Ventures plc, for instance, was granted access to the US market but this grant is subject to further review after Inmarsat conducts an IPO, or revocation of its authorisation to provide non-core services to the US if it fails to conduct an IPO, or if substantial dilution of the aggregate ownership of the company by its former Signatories is not achieved through an IPO. The deadline for the IPO has been postponed several times by Congress, in recognition of the state of the financial markets, most recently via legislation until June 2004, with the FCC extending the deadline further to December 2004.

On 18 May 2004, President Bush signed into law S. 2315, a bill extending by another 12 months the deadline (set by the ORBIT Act) for Intelsat to conduct an IPO, i.e. to 31 June 2005. In January 2005 Intelsat, Ltd. announced its amalgamation with a subsidiary of Zeus Holdings Limited, a company formed by a consortium of equity funds. As a result, in April 2005, the FCC finally announced that it has found Intelsat to be in compliance with all of the privatization requirements of the ORBIT Act. The FCC found that Intelsat has substantially diluted the ownership of its former signatories and thus determined that Intelsat may now provide direct-to-home, direct broadcast satellite, Ka- and V-band satellite services, among others.

After Inmarsat certified that it had fulfilled the privatisation requirements of the ORBIT Act, the FCC determined on June 14, 2005 that it could forgo the requirement for an IPO and was no longer subject to the provisions of Section 602 that prohibited Inmarsat from providing additional services and required the United States to oppose or decline to facilitate applications for new orbital locations to provide additional services.

The Netherlands-based New Skies Inc. (a privatised Intelsat spin-off) was granted market access in the US in 1999 for three years only, and US licensees wanting to access New Skies' satellites were granted the standard 10-year earth station license only in April 2001, after New Skies conducted an IPO and the results of this IPO satisfied the FCC. Furthermore, the FCC linked New Skies' market access to the US to market access by US operators in third countries. The ORBIT Act continues to apply to New Skies N.V. This being said, in May 2002, FCC allowed New Skies' NSS 7 satellite to serve the US market, except for the provision of DTH service. In January 2003, FCC allowed NSS8 to also serve the US market to provide FSS service. New Skies however decided to redeploy NSS 8 in the Indian Region. For its part, France-based Eutelsat in 1999 faced a competing claim by Loral Skynet to use a specific orbital location to provide Fixed Satellite Service to and from the US in spite of the priority rights it had acquired under the *International Telecommunications Union* (ITU) process. Eutelsat and Loral finally came to an agreement in December 1999, as it became clear that the FCC would not allow US earth station operators to link up with Eutelsat's satellite at the disputed orbital location in the absence of a settlement with Loral Skynet. Eutelsat's customers eventually received FCC authorisation to link up with its satellite, but this case, in which the FCC appears to have leveraged its regulatory clout to the advantage of Loral, raised questions about the compatibility of US domestic procedures with the GATS provisions on Domestic Regulation. Finally, SES Loral was authorised in October 2001 to acquire GE Americom and Columbia, subject to FCC approval of increases in the indirect interests held by non-US investors. On 15 August 2003 the FCC authorised SES Global to provide capacity for the delivery of DTH services over their US-licensed FSS facilities on a non-common carrier basis. FCC applied a "DISCO II-like" analysis to make its determination.

These cases show that proceedings by the FCC on spectrum allocation and licensing are not always carried out in an objective, transparent, timely and non-discriminatory manner, and they have raised concerns regarding their compatibility with US WTO commitments. Fortunately, the goodwill of the companies allowed for a positive outcome.

It must be noted that, between April and June 2003, the FCC introduced several reforms in its satellite licensing procedures. In particular, in an order issued in May 2003 the FCC has attempted to expedite the satellite licensing process, creating a single queue for all new satellite applications and two different licensing frameworks: for non-GSO-like satellite systems, the FCC has retained a modified "processing round system". For GSO-like systems, the FCC has adopted a "first come, first served" system. In addition, this order removed existing restrictions on sales of satellite licenses, to facilitate transfers of licenses in the secondary market to parties that can provide a higher-value use, but it imposed certain safeguards to ensure against spectrum speculation and other possible abuses. The rules adopted for non-US-licensed satellite systems are in line with the rules for US-licensed systems, but the DISCO II public interest framework (that considers the effect on competition in the US, spectrum availability, eligibility and operating requirements, national security, law enforcement, foreign policy, and trade concerns) is maintained in addition to those rules for US market access. An ITU priority date is not considered sufficient to show that a non-US-licensed satellite operator will meet all the public interest factors weighed by the FCC and does not preclude the FCC from licensing the operator of a US-licensed GSO satellite on a temporary basis pending launch and operation of a satellite with higher priority in cases where the non-US-licensed satellite has not been launched yet.

Finally, the US still maintains a MFN exemption on the provision of one-way satellite transmission of Direct to Home (DTH), Direct Broadcast Satellite (DBS) and digital audio services, taken by the US at the very end of the GATS negotiations on basic telecom services. The US' initial offer in the current WTO round of negotiations proposes to eliminate these exceptions. Some clarification is however needed on the scope of the offer

Digital terrestrial television

In 1996, the FCC mandated an exclusive transmission standard for digital terrestrial television in the US, known as ATSC. This decision has prevented the technology (DVB-T), developed in Europe and being adopted in several countries around the world, from entering into the US market. Several market players in the US called for a review of the FCC decision regarding, at least, the modulation system of the ATSC transmission standard so as to allow the market to choose the technology best suited for the innovative services and applications to be offered to consumers. Nevertheless, the FCC confirmed its decision in a January 2001 Order, following a period of comparative tests between ATSC and DVB-T modulation systems held in the US whose procedure and results have been disputed by the DVB-T industry. This is in clear contradiction with US Government's calls for technological neutrality and market driven approaches in other sectors, such as mobile communications.

Moreover, as another example of regulatory intervention in this market, the EU notes that on 8 August 2002, the FCC adopted an order requiring that almost all television receivers include digital television reception capability after 1 July 2007 (beginning on 1 July 2004, with receivers with screen sizes 36 inches and above). This order, which aims to speed the conversion to digital television, will further strengthen the position of the ATSC digital transmission standard in the US market. In addition, on 9 June 2005 the FCC modified the schedule by which new broadcast television receivers are required to include the capability to receive over-the-air digital television broadcast signals to further speed up the conversion to digital television.

It must also be noted that legislation has been debated in Congress that would set a firm 7 April 2009, deadline for the end of the digital TV transition and establish a subsidy for the distribution of set-top boxes for households that are dependent on over-the-air TV.

Also noticeable is the adoption by the FCC, on 10 September 2003, of technical standards regarding the distribution of video programming on digital cable systems for devices marketed and labelled as “digital cable ready” and established some encoding rules.

Finally, on 4 November 2003, the FCC adopted an anti-piracy mechanism, known as the “broadcast flag” for digital over-the-air broadcast television to limit the indiscriminate redistribution of copyrighted content via the Internet. The European Commission submitted its views on this matter on 15 March 2004 to the US State Department: stressing that in the particular case of measures intended to guarantee the protection of intellectual property rights in the new digital world, regulators and policy makers must try to achieve a fair balance between the rights of content providers and the interests of other parties, such as consumers, broadcasters and manufacturers of equipment. On 12 August 2004, the FCC released an Order approving 13 digital output protection technologies and recording methods that will give effect to the broadcast flag, including the digital recording technology developed jointly by Philips Electronics North America Corp. and Hewlett Packard. The FCC encouraged the Federal Trade Commission and the Department of Justice to remain vigilant regarding possible anti-competitive behaviour by technology proponents.

However, this Order, as well as a related order concerning the compatibility of TV receivers with cable systems (the so-called “Plug and Play” Order), have been challenged in the US Court of Appeals for the DC Circuit. The FCC asked the Court to stay its proceedings while it reviewed the Orders following Petitions for Reconsideration by Parties on all sides of the issues: in the “Plug and Play Order” case, the Court agreed but in the “Broadcast Flag Order” case, the Court did not and on 6 June 2005 the Court decreed that the FCC lacked jurisdiction to impose the broadcast flag anti-piracy mechanism on manufacturers of TV sets and other apparatus capable of receiving a digital signal. The European Commission services will continue to monitor developments in this area and, in particular, any future initiative at Congressional level to re-instate the broadcast flag and impose a similar protection for digital radio services.

Digital Audio Broadcasting

On 11 October 2002, the FCC approved a technology developed by iBiquity Digital Corporation for the transmission of analogy and digital radio signals and allowed radio stations to begin interim, voluntary digital transmission, deferring consideration of licensing and service rules to a future proceeding. On 15 April 2004, the FCC initiated a proceeding to explore rules for digital audio broadcasting. FCC sought in particular comments on whether the advent of DAB requires the adoption of service rules addressing music piracy.

8.3 Communication/express delivery

In express delivery, whereas the US advocates further liberalisation from third countries in this sector, the barriers to accede the US market remain significant and even appear to have strengthened recently:

- the restrictions on air transport (see Section 8.5 on Transport Services) significantly affect foreign express delivery operators, which relies heavily on this mode of transport;

- on 16 April 2003, an amendment to the Wartime Supplemental Appropriations Act barred airlines that are not effectively controlled by US citizens or 50% of whose turnover derives from foreign companies from the benefits of some military budget appropriations. The second criterion was in effect directed at one single express delivery company and could in effect deprive it from two of its major customers (i.e. State Department and Pentagon);

8.4 Financial Services

The period under review has been characterised by continued difficult operating conditions for financial institutions on both sides of the Atlantic. Evidence of widespread corporate malfeasance, financial misinformation, and violation of conflicts of interest rules has prompted a significant overhaul of elements of the US regulatory system. While welcome in principle, the reform of elements of US Congressional law on company accounts and corporate governance (see Section 8.1 above on the *Sarbanes-Oxley Act*) contained individual elements which could potentially have required EU entities to infringe their domestic obligations, as well as increasing the cost for EU issuers of raising capital in US markets. Much of the focus of EU-US discussions in the field of financial regulation over the past three years has been to find pragmatic and mutually satisfactory solutions to ensure that provisions of the US law do not have unintended consequences for activities of EU established entities and vice-versa.

In general, recognition of equivalence of home-country standards for capital and banking markets would significantly reduce the regulatory burden of firms and financial institutions that are active on both sides of the Atlantic.

With few exceptions – for example, the non-recognition of US insurance exposures reinsured with non-US underwriters for US solvency purposes which results in EU reinsurance companies having to fully collateralise all reinsurance contracts in the US (see below on insurance) – European financial institutions generally enjoy access to US financial markets on the basis of "national treatment". Frequently, concerns relating to access to US financial markets centre on the extent to which compliance with US regulatory provisions is a proportionate or justified condition for providing financial services directly to US-domiciled investors or counterparties given that EU financial institutions are already subject to comparable and demanding authorisation and supervision in Europe. These concerns gain currency as remote trading and investment strategies are already being implemented on a transatlantic basis.

EU and US authorities are now agreed on the need for informal mechanisms to support enhanced information flow and upstream discussions on new regulatory initiatives. To this end, the EU-US Financial Markets Regulatory Dialogue was launched in March 2002 to tackle existing issues of concern to one side or another and to prevent new ones from emerging. The Dialogue has served as the basis for intensive discussions on a range of items of regulatory issues of interest to the other party over the past 12 months.

WTO Financial Services negotiations

In this context, the EU is working to improve access of European financial institutions to US markets in a number of key sectors. Unfortunately, the US has not so far offered major new commitments in financial services.

Financial services negotiations in the framework of the GATS are particularly important. A permanent and MFN-based agreement entered into force in March 1999 and GATS negotiations on financial services were relaunched in Geneva in 2000.

Banking

The international banking community continues to voice concern over the requirement of the Office of the Comptroller of the Currency (OCC) and some State banking supervisors to maintain "asset pledges" in addition to the paid up capital they maintain in their home country. While an asset pledge reform by the New York State Banking Department has significantly reduced the regulatory burden for New-York-state-licensed branches of foreign banks (though even further risk-sensitivity still seems desirable), proposed legislation still has to enable the OCC to set its asset pledge ("capital equivalency deposit") requirement for federally-licensed branches of foreign banks in a risk-sensitive way, too.

Insurance

A remaining impediment for EU insurance companies seeking to operate in the US market is the fragmentation of the market into 56 different jurisdictions, with different licensing, solvency and operating requirements. Each state has its own insurance regulatory structure and, by contrast to banking, federal law does not provide for the establishment of federally licensed or regulated insurance companies. However, interest in establishing an optional federal statutory structure for licensing and regulation of insurance is growing.

The decentralised US regulatory/supervisory structure entails heavy compliance costs for EU companies in each of the 56 jurisdictions. The National Association of Insurance Commissioners (NAIC) is making an attempt to harmonise some basic regulatory requirements between the states, but this will be a long process. The NAIC's recommendations are not binding, so even if state insurance commissioners agree to some further harmonisation, implementation at state level cannot be guaranteed.

A major issue of concern however has been the requirement for: non-US reinsurers to post 100% collateral for their US acceptances (i.e. their US reinsurance business). The collateral requirement is not technically justified and leads to important costs not only for European reinsurers, but also for the US insurance industry and their policyholders. Discussions between the European Commission Services and US insurance commissioners on the collateral issue continue as part of the more general EU-US Financial Markets Regulatory Dialogue and the NAIC-CEIOPS-European Commission Dialogue on Insurance.

Securities

EU securities firms may register as broker-dealers or investment advisers, and in principle may establish both in the form of branches or subsidiaries. However, the establishment of a branch in the US by a foreign securities firm to engage in broker-dealer activities, although legally possible, is in fact not practicable, since registration as a broker-dealer means that the foreign firm establishing the branch has to register and become itself subject to Securities and

Exchange Commission (SEC) regulation. Foreign mutual funds have not been able to make direct public offerings in the US because the SEC's conditions make it impracticable for a foreign fund to register under the *US Investment Company Act of 1940*.

Elsewhere, the SEC has not so far clarified the conditions under which EU exchanges can place trading screens terminals with US professional or institutional investors (without having to register as a "national securities exchange"). The right to place trading screens with US professional/institutional investors could attract increased liquidity for securities admitted to trading on EU exchanges, as well as reducing intermediation costs for US market participants trading EU-listed securities. The efficient and transparent organisation of European exchanges and the demanding regulatory framework in which they operate suggest that regulatory considerations should not be a bar to allowing sophisticated US market participants to trade freely on those exchanges.

EU companies admitted to trading on the New York Stock Exchange (or other US exchanges) continue to have to release financial statements based on US accounting standards (US GAAP). This represents a significant cost for EU companies raising capital in the US. Following the regulation adopted by the Council on 7 June 2002, all listed EU companies are required to prepare consolidated accounts under international accounting standards (IAS) by 2005 – thereby complying with international best practice set by independent accounting standard-setters. In July 2003, a first series of IAS were endorsed as the basis for statutory financial reporting in Europe. The EU believes that EU firms whose financial accounts are published in accordance with IAS should not be required to publish reconciliations to US-GAAP when being listed on US exchanges. The European Commission has encouraged the SEC to work toward the goal of recognition of international accounting standards (IAS). In April 2005, the SEC adopted a roadmap to this end, establishing a goal of eliminating the requirement as early as possible between now and 2009 at the latest.

The regulatory requirements for firms listed on an US exchange have increased significantly over the last few years, especially due to the *Sarbanes-Oxley Act of 2002*. European firms that were listed on US exchanges before this increase in regulatory burden may consider delisting. However, current SEC rules make it virtually impossible for foreign firms to deregister so that they would no longer be subject to the SEC's capital market reporting requirements. Even when they delist from NYSE or NASDAQ, these SEC requirements still apply as long as a registrant has more than 300 US shareholders. It seems almost impossible to prove non-fulfilment of this condition. In December 2005, the SEC issued a proposal that reforms the current requirements. This reform aims at easing the conditions under which deregistration of foreign companies operates. The proposal is currently under review by the European Commission.

8.5 Transport Services

Air Transport

Access by EU carriers to the US market of air transport services is restricted by a number of different measures, from limits on foreign investment to measures adopted in the aftermath of 11 September on security and state aid.

<u>Restrictions on foreign investment</u>

Foreign investors are prevented from taking more than a 49% stake in a US carrier and from holding more than 25% of voting stock. This latter limitation makes US rules on foreign ownership considerably more restrictive than relevant EU rules. Cross border investment is an important driving force behind liberalisation. Reducing foreign ownership restrictions would give better access for carriers to international capital, which in turn would contribute to growth, competitive effectiveness, and the promotion of competition and consumer benefits.

The EU takes note that the US Administration is currently actively considering options to increase the opportunities for US carriers to obtain foreign capital and to have greater involvement with citizens of countries with which it has an Open Skies relationship.

Government procurement restrictions

Section 1117 of the Federal Aviation Act requires that, in general, transportation funded by the US Government (passengers and cargo; mail is covered by separate legislation) must be performed by US carriers. By contrast, in the EU any obligation for government officials to use “national flag” is considered to be anti-competitive and contrary to the Treaty.

Restrictions on leasing of foreign aircraft

US and EU rules on dry leasing are broadly similar in effect. However, Article 8(3) of Council Regulation (EEC) 2407/92 limits leases of foreign registered aircraft by EU carriers to a short term to meet their temporary needs, or otherwise if there are exceptional circumstances. Many EU carriers lease equipment (both with and without flight crew) from US carriers and leasing companies.

US rules on wet lease prevent any lease of non-US registered aircraft by US carriers. No Community-registered aircraft with Community flight crew can thus be leased to US companies. The US authorities subject applications for wet leases by EU carriers of foreign country aircraft for use on routes to the US to a "public interest" test.

In the context of the negotiations for an EU-US agreement in air transport services, the EU took note of the intention of the US Administration to consider the possibility for US carriers to wet-lease equipment with crew from EU carriers on international routes.

Security in aviation

While fully supporting the need to ensure the highest levels of security in aviation, the EU has some serious concerns about the manner in which measures have been introduced. There is a worrying tendency towards the imposition of aviation security measures in an extraterritorial manner at airports on European soil. Many security rules have also been imposed without due warning and without proper consultation with EU authorities and the European industry as to their efficacy and practicality. Provisions in the *Vision-100 FAA Reauthorization Act of 2003*, and the *Intelligence Reform and Terrorist Prevention Act of 2004* raise similar concerns, as well as questions on their impact on EU aviation security regulatory requirements.

Of particular concern is the imposition of Advanced Passenger Information System (APIS) and the requirement for airlines to provide access to data processed by their reservation and departure control systems, in particular Passenger Name Records (PNR). US authorities have made the formerly voluntary APIS system mandatory, imposed high accuracy rates, and required access to PNR. EU airlines have been forced to comply under threat of possible heavy fines, submitting passengers of non-compliant airlines to burdensome secondary inspections, or eventual withdrawal of the airline’s landing rights.

In addition, a Final Rule published in the Federal Register of 7 April 2005 mandates the transmission of data elements which are not currently collected under the APIS system by 4 October 2005. Of particular concern is US consideration of a system that would require airlines to provide their final APIS manifest 60 minutes prior to scheduled departure. This would have a serious impact on hub operations, minimum connecting times, terminal capacity and ultimately the entire network carrier business model.

However, these requirements raise concerns not only because of the technical and doing-business limitations of the present system, but because, in the case of PNR, of the difficulties arising from the application of European law on data protection. In order to establish a legally sound basis for the transfer of data, the European Commission and US authorities engaged in discussions with a view to a bilateral arrangement in this area.

The framework finally adopted for PNR is made up of three intertwined elements:

(i) the unilateral Undertakings issued on 11 March 2004 by the US Bureau of Customs and Border Protection (CBP), Department of Homeland Security (DHS), and published in the Federal Register of 9 July 2004 setting out the treatment that passenger data transferred by European airlines to CBP will receive;

(ii) the European Commission Decision C(2004) 1914 of 14 May 2004, establishing the adequacy of the data protection granted by CBP to PNR data (OJ L 235 of 6 June 2004); and

(iii) an EU-US Agreement, establishing the legal basis for such transfers, signed in Washington on 28 May 2004.

On 20-21 September, 2005, delegations from DHS and the European Commission performed the first Joint Review of the Undertakings of the DHS Bureau of Customs and Border Protection (CBP) concerning Passenger Name Record (PNR) information derived from flights between the US and the EU. Prior to the Joint Review, the DHS Privacy Office conducted an internal review of CBP policies, procedures, and technical implementation related to the data covered by the Undertakings.

On security screening services, the EU notes with concern that *Section 108 of the Aviation and Transportation Security Act* (ATSA) contains discriminatory clauses against foreign providers of security services. After an initial period of nationalisation, the Act allows for pilot programmes and the eventual re-entry of private firms into US airports, but it bars the entry of firms not owned and controlled by a citizen of the US. Given that European multinational corporations are among the world leaders in the provision of security services both at airports and generally, this discrimination represents a major step backwards in trade terms. It also represents a violation of the US specific commitments under the GATS, according to which the US is bound to impose no restrictions on the establishment of foreign security services.

On 23 June 2004 the US Department of Homeland Security released the Transportation Security Administration’s (TSA) “Guidance on the Screening Partnership Program” (SPP). The document provides initial information for airports that may be interested in having private companies provide screeners. The guidelines confirm the requirements of Section 44920 (of ATSA) and states that TSA shall allow an airport operator to submit an application only if provided by companies owned and controlled by US citizens, to the extent such companies exist. This goes against the WTO/GATS commitments by the US in the area of security services, which does not allow for discrimination (for both market access and national treatment of companies) between private operators on the basis of citizenship/nationality.

There is a need for a better regulatory convergence and compatibility of EU and US rules in the field of aviation security.

State aid for airlines

Whilst recognising the severe financial consequences of 11 September 2001 on US airlines and the need to ensure that vital transport services in the US were maintained, the EU is concerned about the scale of financial assistance provided by the US Government to US air carriers, particularly since financial problems of many airlines predated 11 September. This assistance could place US airlines at an unfair advantage compared to their European competitors who have received only tightly controlled compensation for the four-day closure of US airspace. In the US in the months after 11 September, $5 billion was made available to US airlines according to their size and a further $10 billion was made available in loan guarantees to ailing companies. A second round of aviation related assistance totalling $2.4 billion was also provided in the *Emergency Supplemental Appropriations Act of 2003*. The government has supplied third party war risks insurance at virtually no cost to US airlines and their suppliers. Although similar coverage was provided by several EU Member States, this was only done for a limited period and against payments of premiums. The overall assistance given by the US Government to the US industry represents significant protection from the commercial pressures facing foreign air carriers and is a potential impediment to fair trade on transatlantic air routes.

Other areas of state aid include the Transportation Security Administration (TSA) awarded reimbursement grants totalling $100 million to 58 domestic air carriers for the direct cost of reinforcing cockpit doors. This grant money is in addition to $97 million for domestic carriers that the Federal Aviation Administration (FAA) awarded for the same purpose.

In addition, in recent years four major US carriers have sought bankruptcy protection under Chapter 11, and two have terminated and transferred their pension plans to a federal corporation, the Pension Benefit Guaranty Corporation (PBGC). Pension reform legislation pending before the Congress, if adopted, would provide specific relief to US airlines, allowing them an additional 20 years to pay their pension liabilities.

There is a need for a better regulatory convergence of EU and US rules in the field of government subsidies in this area.

Maritime Transport

WTO negotiations on international maritime transport were suspended on 28 June 1996 with members agreeing to observe a standstill clause pending further negotiations. Resumption of these negotiations was an integral part of the new round on services launched in 2000 and, as such, those negotiations are being undertaken in the context of the DDA negotiations. The EU regretted that, during the previous negotiations, the US did not table an offer relating to maritime transport services, and hopes that the US will endeavour to achieve a multilateral agreement in order to create a better environment for shippers and ship-operators. The EU believes that renewed maritime negotiations would provide an opportunity to cover all aspects of modern door-to-door shipping, including commitments on multimodal activities, and that the most effective means to achieve the widest possible liberalisation is through the WTO. Unfortunately the US has not yet included any maritime commitments within its offer made in the services component of the Doha Round, submitted to WTO within the framework of the DDA.

While international maritime transport markets in the US are predominantly open, significant restrictions remain on the use of foreign built vessels in the US coastwise trade and in relation to access to certain international cargoes from which non-US vessels are excluded.

Restrictions on coastwise trade

Under the *Merchant Marine Act of 1920* (so called *Jones Act*), foreign-built (or rebuilt) vessels are prohibited from engaging in coastwise trade either directly between two points of the US or via a foreign port. Trade with US island territories and possessions are included in the definition of coastwise trade. Moreover, the definition of vessels has been interpreted by the US Government to cover hovercraft and inflatable rafts. Limitations on rebuilding act as another discrimination against foreign materials: the rebuilding of a vessel of over 500 gross tonnes (gt) must be carried out within the US if it is to engage in coastwise trade. A smaller vessel (under 500 gt) may lose its existing coastwise rights if the rebuilding abroad or in the US with foreign materials is extensive (46 USC 83, amendments of 1956 and 1960). In the context of the negotiations for the OECD Shipbuilding Agreement (see Section 5.10 on Subsidies), it was agreed that the Jones Act would be subject to a special review and monitoring procedures.

In addition, no foreign-built vessel can be documented and registered for dredging, towing or salvaging in the US. Third countries are therefore unable to have access to the US market at a time when part of the US fleet needs renewing and many US ports are in need of dredging.

<u>Restrictions related to public procurement</u>

The US has a number of statutes in place that require certain types of government-owned or financed cargoes to be carried on US-flag commercial vessels. The impact of these measures is significant; they deny EU competitors access to a very sizeable pool of US cargo, while providing US ship owners with guaranteed cargoes at protected, highly remunerative rates.

The application of these measures to US public procurement contracts introduces uncertainty for those businesses whose tenders include shipping goods to the US. Whether they are required to ship the goods on US-flagged vessels, which charge significantly higher freight rates than other vessels, is not known until after the award of the contract (see Section 5.7 on Public Procurement).

The relevant legislative provisions are:

- The *Cargo Preference Act of 1904* requires that all items procured for or owned by the military departments be carried exclusively on US-flag vessels.

- *Public Resolution N°17*, enacted in 1934, requires that 100% of any cargoes generated by US Government loans (i.e. commodities financed by Export-Import Bank loans) be shipped on US-flag vessels, although MARAD may grant waivers permitting up to 50% of the cargo to be shipped on vessels of the trading partner.

- The *Cargo Preference Act of 1954* requires that at least 50% of all US government-generated cargoes covered be carried on privately owned US flag commercial vessels if they are available at fair and reasonable rates.

- The *Food Security Act of 1985* increases to 75% the minimum proportion of agricultural cargoes under food aid programmes to be shipped on US-flag vessels. The additional cost is subsidised by the USDA and the MARAD and charged out of US food aid funds.

- The *Alaska Power Administration Sale Act of 1995*, while removing the prohibition on the export of Alaska crude oil, retained the pre-existing US flag vessel carriage requirement of such exports.

9 US COMPLIANCE WITH WTO DISPUTE SETTLEMENT RECOMMENDATIONS

Article 21.1 of the WTO Understanding on Dispute Settlement (DSU) states that prompt compliance with recommendations and rulings of the Dispute Settlement Body (DSB) is essential in order to ensure effective resolution of disputes to the benefit of WTO Members. Moreover, *Article 3 of the DSU* affirms that "the dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system".

Notwithstanding these provisions, the US does not have a good record with regard to compliance with recommendations and rulings formulated by the DSB on the basis of Panels' and the Appellate Body's reports. As a matter of fact, no other WTO Member has failed on so many occasions to respect the terms of the DSB rulings. This serious situation is not sustainable in the long run. For the WTO system to function for the benefit of all, Members have to act in good faith to maintain the value of their reciprocal concessions and to respect and implement the agreed rules.

The US have been very slow in implementing WTO rulings which have come out against aspects of its trade defence legislation (e.g. more than 3 years in the 1916 US Antidumping Act dispute), or have implemented rulings in a questionable manner (e.g. the approach used by the US DoC as regards “sunset” measures in privatisation cases) or have failed to implement rulings altogether (e.g. no implementation yet in the “Byrd Amendment” dispute).

The most egregious examples are listed below:

- The ***Continued Dumping and Subsidy Offset Act*** (so-called “Byrd Amendment”) (see Section 5.8).
- ***US Countervailing Duty Measures in the case of British Steel*** (see Section 5.8).
- The ***Foreign Sales Corporation*** case (see Section 5.10).
- ***Section 110(5) of the US Copyright Act*** (see Section 7.1).
- ***Section 211 of the Omnibus Appropriations Act*** (see Section 7.3).

LIST OF FREQUENTLY USED ABBREVIATIONS

ANSI	American National Standards Institute
APHIS	Animal Plant and Health Inspection System
ASCM	WTO Agreement on Subsidies and Countervailing Measures
ASME	American Society of Mechanical Engineers
CBP	US Bureau of Customs and Border Protection (Department of Homeland Security)
CDSOA	Continued Dumping and Subsidy Offset Act
CHIC	Cosmetics Harmonisation and International Cooperation
CSF	Classical Swine Fever
CSI	Container Security Initiative
DDA	Doha Development Agenda
DoC	Department of Commerce
DoD	Department of Defence
DoT	Department of Transport
DSB	WTO Dispute Settlement Body
DSU	WTO Dispute Settlement Understanding
EC	European Community
EPA	Environmental Protection Agency
EU	European Union
FAA	Federal Aviation Administration
FCC	Federal Communications Commission
FDA	Food and Drug Administration
FDI	Foreign Direct Investment
GAO	General Accountability Office
GATS	General Agreement on Trade and Services
GATT	General Agreement on Tariffs and Trade
GPA	WTO Government Procurement Agreement
GSM	General Sales Manager
IEC	International Electrotechnical Commission
IPR	Intellectual Property Rights
ISO	International Standardisation Organisation
ITC	International Trade Commission
ITU	International Telecommunications Union
MARAD	Maritime Administration
MFN	Most-favoured Nation
NASA	National Aeronautics and Space Administration
NATO	North Atlantic Treaty Organisation
NOAA	National Oceanic and Atmospheric Administration
NTA	New Transatlantic Agenda
OECD	Organisation for Economic Co-operation and Development
OIE	World Organisation for Animal Health
OSHA	Occupational Safety and Health Administration
R&D	Research and Development
SEC	Securities and Exchange Commission
SPS	Agreement on the Application of Sanitary and Phytosanitary Measures
TABD	Transatlantic Business Dialogue
TBT	Technical Barriers to Trade Agreement
TEP	Transatlantic Economic Partnership

TRIPs	WTO Agreement on Trade Related Aspects of Intellectual Property Rights
TRQ	Tariff Rate Quota
USDA	US Department of Agriculture
USTR	US Trade Representative
WCO	World Customs Organisation
WIPO	World Intellectual Property Organisation
WTO	World Trade Organisation